

Fixture Financing under the PPSA: The Ongoing Conflict between Realty and Fixture-Secured Interests

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Fixture Financing under the PPSA: The Ongoing Conflict between Realty and Fixture-Secured Interests

Abstract

Section 36 of the Ontario Personal Property Security Act (PPSA) purports to resolve conflicts arising between parties of realty and fixture-secured interests by balancing their reliance interests. The PPSA achieves this objective by ushering in some important substantive changes with respect to fixture law in Ontario. On the whole, the author states; the policy behind these rules is a sound one. Unfortunately, a plethora of problems still lurk in this complicated area of law, in part due to the formulation of the fixture section. A number of these problems are identified and examined. The author suggests that many of these problems can be resolved by judicial construction. For others, however, nothing short of legislative measures will do to make the section more workable and trouble-free.

FIXTURE FINANCING UNDER THE PPSA: THE ONGOING CONFLICT BETWEEN REALTY AND FIXTURE- SECURED INTERESTS

BY MICHAEL E. BURKE*

Section 36 of the Ontario Personal Property Security Act (PPSA) purports to resolve conflicts arising between parties of realty and fixture-secured interests by balancing their reliance interests. The PPSA achieves this objective by ushering in some important substantive changes with respect to fixture law in Ontario. On the whole, the author states, the policy behind these rules is a sound one. Unfortunately, a plethora of problems still lurk in this complicated area of law, in part due to the formulation of the fixture section. A number of these problems are identified and examined. The author suggests that many of these problems can be resolved by judicial construction. For others, however, nothing short of legislative measures will do to make the section more workable and trouble-free.

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I. INTRODUCTION

As the Ontario economy expanded over the last four decades, it became quite obvious that the laws governing vital aspects of business activity had become a "tangled mass."¹ The Ontario *Personal Property Security Act*,² which is based on the 1962 version of Article 9 of the United States *Uniform Commercial Code* (UCC),³ was introduced in Ontario to clear away this chaos. The *Act* consolidates, simplifies, clarifies, and modernizes the law of secured transactions so that it is in harmony with sound business practices.⁴ The *Act* goes a long way toward meeting this objective. However, one of a number of obstacles in this otherwise happy road to encouraging and facilitating commercial transactions has been

¹ F.M. Catzman *et al.*, *Personal Property Security Law in Ontario* (Toronto: Carswell, 1976) at 1.

² R.S.O. 1980, c. 375, as am. S.O. 1981, c. 2 & c. 58 [hereinafter *PPSA*]. All section references to the *Act* or the *PPSA* or not otherwise identified are to the Ontario *PPSA*.

³ National Conference of Commissioners on Uniform State Laws, *Uniform Commercial Code: 1962 Official Text With Comments* (Philadelphia: American Law Institute, 1963) [hereinafter *1962 Code*].

⁴ The comprehensiveness of the *PPSA* can best be demonstrated by the acts that it replaces: the *Assignment of Book Debts Act*, R.S.O. 1970, c. 33; the *Bills of Sale and Chattel Mortgages Act*, R.S.O. 1970, c. 45 (except as to sales); and the *Conditional Sales Act*, R.S.O. 1970, c. 76. See also Catzman *et al.*, *supra*, note 1 at 2 where a list of other statutes affected in part by the *PPSA* can be found.

the operation of section 36, the fixture section. Section 36 purports to resolve conflicts arising between a person who claims an interest in real estate, including any fixtures thereon, and one who claims an interest against a particular fixture. In determining the priorities among realty and fixture interests, section 36 is one of the few exceptions⁵ to the general rule that the *PPSA* is concerned only with personal property and has no impact upon the law of real property.

On a policy level, the fixture section appears to balance fairly the reliance interest of both the real estate and fixture parties and expands the protection previously available to the latter under the *Conditional Sales Act*.⁶ As will become evident, the *PPSA* encourages the commitment of new capital to the improvement of real estate and the modernization and expansion of industry while at the same time protecting the capital that has already been committed.

Unfortunately, the formulation of the section is expected to generate a bewildering assortment of problems with respect to fixture determination, perfection and real estate notification, construction mortgages, tenants' fixtures, and fixtures installed by contractors.⁷ These problems, which have been selected for the present discussion, are not necessarily the most difficult or the most intellectually stimulating. They are, however, likely to arise in significant numbers because they are latent in a large proportion of fixture transactions.

Although few cases have been decided under the section⁸ and little has been written about the treatment of fixtures in

⁵ Only ss 1(r), 1(y), 3(1)(e)(i) & (ii), 36, 36a, 54 & 56(6) touch on real estate matters. Sections 1(k), 10(b), 12(2)(a) & (d), 13(2)(a), 34 & 54 deal with crops or timber.

⁶ *Supra*, note 4, s. 10(1), which provided that where the goods, other than building material [*sic*], have been affixed to realty, they remain subject to the rights of the seller as fully as they were before being so affixed, but the owner of the realty or any purchaser or any mortgagee or other encumbrancer thereof has the right, as against the seller or other person claiming through or under him, to retain the goods upon payment of the amount owing on them.

⁷ This is only a partial list of the problems that are likely to emerge out of s. 36. For additional problems, see the comprehensive article by D.F. Adams, "Security Interests in Fixtures Under Mississippi's Uniform Commercial Code" (1976) 47 Miss. L.J. 831.

⁸ R.H. McLaren and K. de Jong, *Secured Transactions in Personal Property in Canada*, vols. 1-3 (Toronto: Carswell, loose-leaf, Release No. 25, December 1986) at §§ 6.03[2][b], 6.06[2][b] & 6.09[2][b] [hereinafter McLaren I] cites six cases: *Charles A. Hare Ltd v. Payn* (1982), 2 P.P.S.A.C. 93 (Ont. S.C.) [hereinafter *Charles A. Hare Ltd*] (a motor truck scale); *Cormier v. Federal Business Development Bank* (1983), 3 P.P.S.A.C. 161 (Ont. Co. Ct.) [hereinafter *Cormier*] (equipment installed in a tenant's place of business); *Assiniboine Credit Union Ltd v. C.I.B.C.* (1984), 4 P.P.S.A.C. 96 (Man. C.A.) (a house); *Manning v. Furnasman Heating Ltd* (1985), 4 P.P.S.A.C. 246 (Man. Q.B.), *aff'd* on other grounds, 5 P.P.S.A.C. 67 (Man. C.A.) [hereinafter *Manning*] (gas furnace, water heater, ductwork, eavestroughing, and pipes); *Dolan v. Bank of Montreal* (1985), 5 P.P.S.A.C. 196 (Sask. C.A.) (a mobile home); and *Leslie and Palmer Co. v. Hydrogrowers Corporation* (1986), 5 P.P.S.A.C. 292 (Ont. Dist. Ct.) (an electrical substation and related pole-mounted equipment). Only

Ontario⁹ and in the other Canadian *PPSA* jurisdictions,¹⁰ this is no reason for maintaining the status quo. Indeed, Article 9-313 of the *1962 Code* (the precedent for section 36 of the *PPSA*) has provoked much criticism in the United States.¹¹ Eminent commentators and members of the U.S.

the *Cormier* case really considers and applies the provisions in s. 36. In *Manning*, the Manitoba Queen's Bench applied s. 36 of the Manitoba *PPSA* in respect of goods affixed by contractors, but the Court of Appeal decided the case without relying on the fixture provision. This particular problem is examined later in this article; see Part VI, "Goods Affixed By Contractors," *infra*.

Professor Gilmore has queried why there has been so little litigation on this subject since 1940 (see G. Gilmore, "The Purchase Money Priority" (1963) 76 Harv. L. Rev. 1333 at 1363). Three reasons have been suggested to explain this phenomenon. First, the law of secured transactions is traditionally tested only after prolonged periods of economic depression, which is not fully reflected in either *UCC* or *PPSA* case law (see P.F. Coogan *et al.*, *Secured Transactions under the Uniform Commercial Code*, vol. 1 (New York: Matthew Bender, loose-leaf, 1986) at § 3A.01 [hereinafter Coogan 1]; R.D. Henson, *Handbook On Secured Transactions Under the Uniform Commercial Code*, 2d ed. (St. Paul: West, 1979) at 292-93). Second, conflicts between fixture security interests and land mortgages have been rare over the last forty years because rising land values have ensured that the building and the fixture together have, or will have in the future, sufficient value to cover both debts (see M.G. Shanker, "An Integrated Financing System For Purchase Money Collateral: A Proposed Solution to the Fixture Problem Under Section 9-313 of the Uniform Commercial Code" (1964) 73 Yale L.J. 788 at 792). Finally, because of the number of difficulties inherent in this section, the various competing parties have drafted agreements that attempt to overcome many of the problems (see R.H. McLaren, "O.P.P.S.A. as it Affects Chattels, Fixtures and Leasehold Improvements" in H.M. Haber, ed., *Shopping Centre Leases: A Collection Of Articles and Precedents*, vol. 2 (Agincourt, Ont.: Canada Law Book, 1982) 225 at 267 [hereinafter McLaren II]).

⁹ See McLaren II, *ibid.*; *Report of the Pers-Real Committee of the Real Property Section* (Toronto: Canadian Bar Association (Ontario Division), 1982) at 13-21 [hereinafter *Pers-Real Report*]; B. Crawford, "A Practitioner's Notes Upon the Ontario Personal Property Security Act" (1975-76) 1 Can. Bus. L.J. 269 at 306-9; Catzman *et al.*, *supra*, note 1 at 159-63, 209-11. See generally McLaren I, *ibid.* at § 6.03[2][b] (Ontario), § 6.06[2][b] (Manitoba) and § 6.09[2][b] (Saskatchewan & Yukon).

¹⁰ In addition to Ontario, personal property security legislation has been enacted in Manitoba (S.M. 1973, c. 5) [proclaimed in force September 1, 1978], Saskatchewan (S.S. 1979-80, c. P.6.1, as am.) [proclaimed in force May 1, 1981], and the Yukon Territory (S.Y.T. 1980 (2d), c. 20) [proclaimed in force June 1, 1982]. Other provinces have also shown a great deal of interest in enacting personal property security legislation of their own. For a discussion of Alberta's most recent attempt, see R.C.C. Cumming, "Alberta Moves toward Enactment of a Personal Property Security Act" (1985) 11 Can. Bus. L.J. 82.

¹¹ Of the fifty-one jurisdictions (the District of Columbia, the Virgin Islands, and all of the states except Louisiana) to adopt the *1962 Code*, thirty-six have departed from its treatment of fixtures because they found its provisions extreme or ambiguous. While many of the changes were inconsequential, others were more fundamental. For example, Ohio initially accepted the official *Code* but after a year rewrote the section to reverse its general policy, returning the state to its pre-*Code* law of priorities. California simply refused to adopt § 9-313 when it enacted the *Code* because it feared that the section would only further confuse California law on fixtures: *Cal. Comm. Code Ann.* § 9-313 (St. Paul: West, 1964). For other individual state variations from the *1962 Code*, see *ucc Report Service: State Correlation Tables* (Mundelein, Ill.: ucc Report Service, 1979).

As well, when real estate lenders began to realize the impact of the fixture provision on real estate financing, they were displeased not only with § 9-313's ambiguity but also with the substantial change from prior law and the lack of adequate safeguards for real estate interests (e.g., construction mortgagees): see Permanent Editorial Board for the *UCC*, Review Comm. for Article 9, *Reasons for Change* (Final Draft 1971).

The need for clarification and re-evaluation was also voiced by commentators and members of the bar: see, for example, G. Gilmore, *Security Interests in Personal Property*, vol. 2 (Boston: Brown, Little, 1965) at 801; P.F. Coogan *et al.*, *supra*, note 8, vol. 1B, c. 16A, 17A & 17B [hereinafter Coogan 1B]; H. Kripke, "Fixtures Under the Uniform Commercial Code" (1964) 64 Colum. L. Rev. 44; Shanker, *supra*, note 8.

Bar generally agree that every subsection of Article 9-313 except subsection 9-313(5), which is comparable to section 36(4) of the *PPSA*, is either ambiguous, incomplete, or challengeable on policy grounds.¹² Such vagueness in the *PPSA* is not acceptable when the provisions of a security agreement will only be tested after the normal business relationship is strained to the point where no resolution can be achieved through an adjustment of mutual interests. Even if the debtor and secured party are willing to make their own bargain after problems have arisen, they will be restrained from doing so because the *Act* will by that time have become fully operative and the rights of third parties (for example, the trustee in bankruptcy and the other parties listed in section 22) will also have to be considered.¹³

As a result, in 1971 the sponsors of the United States *UCC* approved *substantial* changes to Article 9's fixture-related provisions, which are embodied in the 1972 version of the *Code*.¹⁴ In contrast, in Ontario, the Advisory Committee for the Ministry of Consumer and Commercial Relations has recently recommended only a *few* amendments with respect to the fixture section and most are procedural rather than substantive.¹⁵ In the author's opinion, the section fails to meet the fundamental aims of the *Act*:¹⁶ "to provide rules under which commercial transactions can be conducted with reasonable simplicity and certainty"¹⁷ and "to be responsive to the needs of [a] modern economy."¹⁸ This paper will, therefore, compare Ontario's current and proposed treatment of security interests in fixtures with both the 1962 and the 1972 *Codes* in the hope that the comparison will highlight the desirability of further amending section 36 of the *PPSA*.

¹² See, e.g., I. Gordon, "Credit Sales of Installed Equipment — The Uniform Commercial Code's Uneasy Truce Between Realty and Chattel Financing Interests" (1970) 64 *Nw. U.L. Rev.* 651 at 661.

¹³ Coogan 1, *supra*, note 8 at § 3A.01.

¹⁴ National Conference of Commissioners on Uniform State Laws, *Uniform Commercial Code: 1972 Official Text With Comments and Appendix* (Philadelphia: American Law Institute, 1973) [hereinafter 1972 *Code*]. As of January 1986, forty-six jurisdictions had adopted the 1972 *Code*. See Bender's Uniform Commercial Code Service, *Secured Transactions under the Uniform Commercial Code: 1986 Cumulative Supplement* (Albany, New York: Matthew Bender & Co., 1986).

¹⁵ Ontario, *Report of the Minister's Advisory Committee on the Personal Property Security Act* (Toronto: Ministry of Consumer & Commercial Relations, 1984) at 54-55 [hereinafter 1984 *Draft Act*]; Ontario, *Supplementary Report of the Minister's Advisory Committee on the Personal Property Security Act* (Toronto: Ministry of Consumer & Commercial Relations, 1985) at 47-49 [hereinafter 1985 *Draft Act*]. In the 1985 *Draft Act*, no changes were made to the text dealing with fixtures from that proposed in the 1984 *Draft Act*.

¹⁶ This negative assessment of the fixture provision is based on the assorted problems inherent in the section. See note 7, *supra* and accompanying text.

¹⁷ Catzman *et al.*, *supra*, note 1 at 3.

¹⁸ *Ibid.* at 13.

II. THE MEANING OF FIXTURES

Legislative efforts in the United States to create a meaningful definition of the term 'fixtures' have proved unsuccessful.¹⁹ Perhaps because of the previous failures, those who drafted the *1962 Code* decided not to define this term. There is substantial disagreement among those who have commented on the *1962 Code* about the seriousness of the omission.²⁰ Even if such a definition could be composed, it would probably create more problems than it solves. First, an all-embracing definition would soon become outmoded as technology continually spawns new fixtures and methods of installation.²¹ Second, given the variability of fact patterns and the emotional appeals of different types of claimants, one would expect that each case would ultimately be decided on its particular facts.²² Thus, it would be unwise to freeze in statutory form what must vary with time and place. As a result, in all of the provinces

¹⁹ See, e.g., the definition of fixtures in the *Ga. Code Ann.* § 85-105 (1933):

[A]nything intended to remain permanently in its place, though not actually attached to the land, such as a rail fence, is a part of the realty and passes with it. Machinery, not actually attached, but movable at pleasure, is not a part of the realty. Anything detached from the realty becomes personalty instantly on being so detached.

As quoted in M.W. Macey, "Bringing Your Fixtures Up To Date" (1965) 16 *Mercer L. Rev.* 404 at 404 n. 2.

Recent legislative attempts in Canada have been no more successful. See s. 2(p) of the Saskatchewan *PPSA*, *supra*, note 10, which defines "fixtures" to mean "goods that are installed on or affixed to real property in such a manner or under such circumstances as to result in their becoming in law fixtures to the realty, but does not include building materials." Essentially the same definition is contained in s. 2(1) of the Yukon *Personal Property Ordinance*, *supra*, note 10.

²⁰ Professor Gilmore concludes that no satisfactory definition of 'fixtures' can be developed and that in any case multiple filings would overcome this problem: Gilmore, *supra*, note 11 at 819-20. Mr. Coogan concludes, however, that a definition is essential, and he offers such a definition (see Coogan 1B, *supra*, note 11 at §§ 17.09, 17.14(2), 17.14(4)). Professor Kripke is wary of any definition that depends on the degree of affixation and he suggests as an appropriate definition "anything that would pass by a real estate conveyance by the owner of the property, but excluding the sand, plaster, structural members, and so on, to which the rules of accommodation do not apply" (see Kripke, *supra*, note 11 at 64). See also the definition drafted by Kripke for the Review Committee's first published draft of the *1972 Code*: Review Committee for Article 9 of the Uniform Commercial Code, Permanent Editorial Board for the Uniform Commercial Code, *Preliminary Draft No. 1* (St. Paul: West, 1968), § 9-313(1)(b)(i) as quoted in Coogan 1, *supra*, note 8 at § 3A.02[1] n.42. Professor Cosway cynically writes that the "[s]election of a workable definition of the word 'fixture' is almost impossible, because the definition adopted will usually reflect a preconceived judgment concerning the merits of the particular case." He therefore concludes that "defining the term 'fixture' is much less significant than applying the definition to particular fact patterns.": R. Cosway, "Fixtures Under The Uniform Commercial Code" (1967) 21 *Sw. L.J.* 713-14.

²¹ See, e.g., *Schiedell v. Burrows* (1902), 1 O.W.R. 793 (Trial Ct.) where Mr. Justice Britton suggested that the old rules applicable to fixtures were being relaxed because of the constant advances that were being made with respect to trade machinery; *Clark v. Brager* (1934), [1934] 3 D.L.R. 265 at 270-71 (N.B.S.C.A.D.). See also *Leigh v. Taylor* (1902), [1902] A.C. 157 at 159 (H.L.), Lord Halsbury.

²² See *Report on Landlord and Tenant Law* (Toronto: Ontario Law Reform Commission, 1976) at 76 where the Commission wrote: "Difficulty in reconciling the judicial decisions on the subject of fixtures arises from the heavy reliance of each decision upon the facts of the particular case." See also Cosway, *supra*, note 20 at 713.

except Quebec, the determination of when goods become fixtures is left to the common law.²³ The PPSA does, however, provide that there cannot be a chattel security interest in "building materials that have been affixed to the realty."²⁴

Taken as a whole, section 36 provides more insight into the meaning of 'fixtures' than is apparent upon first reading. The PPSA envisions a three-way classification of property: building materials; chattels that have not become fixtures and remain personal property; and fixtures.²⁵ First, 'building materials' that have become so closely associated with realty that they have lost their independent character are considered as realty for all purposes ('pure realty'). Security interests in goods of this first class are governed by real property law and not by the PPSA.²⁶ Accordingly,

²³ Unfortunately, the common law does not provide a very useful guide for the determination of whether or not a chattel is a fixture. The inconsistency of the case law on fixtures has attracted comment from at least three judges. In *Carscallen v. Moodie* (1857), 15 U.C.Q.B. 304 at 316 (C.A.), Robinson C.J. stated that

[i]t must be confessed that the language of the courts, in the multiplicity of cases respecting fixtures, is full of apparent inconsistencies, arising in a great measure from the different aspects in which the question happened to be presented, whether as between heir and executor, vendor and vendee, tenant for life or in tail and the remainder man, or landlord and tenant; and there are in truth many cases of which it is acknowledged that they are incapable of being reconciled.

Similarly, Patterson J.A. in *Keefer v. Merrill* (1880), 6 O.A.R. 121 at 136 stated:

I find it impossible to follow the discussion of the question, as it has arisen in a very large number of cases, whether certain articles are or are not fixtures, with any confidence in my ability to discover a principle that will satisfactorily apply to all cases. The distinctions made are sometimes so fine as not to be easily perceptible, and I am inclined to think that the task to bring all the decisions into harmony would be a hopeless one.

Most recently, McFarlane J.A. observed in *LaSalle Recreations Ltd v. Canadian Camdex Investments Ltd* (1969), 4 D.L.R. (3d) 549 at 553 (B.C.C.A.) [hereinafter *LaSalle Recreations*] that "[i]t is probably an understatement to say that it would be very difficult to reconcile many decisions relating to this subject."

For a discussion of Canadian fixture law in general, see F.W. Rhodes, *Williams and Rhodes on Canadian Law of Landlord and Tenant*, vol. 2, 5th ed. (Toronto: Carswell, loose-leaf, Release No. 15, 1986) at 13:10; A.H. Oosterhoff & W.B. Rayner, *Anger and Honsberger Law of Real Property*, vol. 2, 2d ed. (Aurora, Ont.: Canada Law Book, 1985) at 1009; W.B. Rayner & R.H. McLaren, eds., *Falconbridge on Mortgages*, 4th ed. (Agincourt, Ont.: Canada Law Book, 1977) at 19; *Report on Landlord and Tenant Law*, *ibid.* at 75; D.L. Campbell, "Fixtures and Improvements Including the Rights of Conditional Vendors and Chattel Mortgagees" in Special Lectures of Law Society of Upper Canada, *The Lease in Modern Business* (Toronto: Richard de Boo, 1965) at 45; and H.E. Manning, "The Canadian Law of Fixtures" [1927] 1 D.L.R. 289, reprinted in 2 *Dominion Law Annotations* 1084.

²⁴ Section 1(y).

²⁵ Most commentators agree that three classes of property are contemplated. See, e.g., McLaren I, *supra*, note 8 at § 6.03[2][b][i]; J.S. Ziegel & B. Geva, *Commercial and Consumer Transactions: Cases, Text and Materials* (Toronto: Emond-Montgomery, 1981) at 1046. A tripartite division of property is also contemplated in § 9-313 of the 1962 and 1972 Codes, see Coogan IB, *supra*, note 11 at §§ 16.07, 17.09, 17.12[1]; J.J. White & R.S. Summers, *Handbook of the Law under the Uniform Commercial Code* (St. Paul: West, 1972) at 925; Kripke, *supra*, note 11 at 62-64. But cf. Professor Gilmore's interpretation of § 9-313, which would recognize only two classes of property — realty and personality: Gilmore, *supra*, note 11 at 813-14.

²⁶ *Supra*, note 24.

suppliers of building materials must seek to protect their security interests through a mechanic's lien under the *Construction Lien Act*²⁷ or a real estate mortgage. Second, chattels that are used in connection with real estate but that have not become fixtures under the common law remain personal property for all legal purposes ('pure personalty'). Such goods retain their personalty status and security interests in them are governed by sections of the *PPSA* other than section 36.²⁸ Third, chattels that by reason of their close association with realty have become 'fixtures' according to the common law take on the character of real property for some legal purposes but retain sufficient character as personal property to remain or become subject to the *PPSA*. It is these 'fixtures' to which the rules of section 36 of the *PPSA* apply.

One can, therefore, view this third case as a central gray area that lies on a continuum running from pure personalty to pure realty.²⁹ Consequently, the courts will have to delineate the two lines that bound the fixture area: on the one side a court must distinguish fixtures from goods that have become an integral part of the structure (building materials) so as to become real property, and on the other side of the continuum it must distinguish fixtures from goods not sufficiently incorporated to lose the status of pure personalty.

A. *Building Materials Versus Fixtures*

Courts and commentators alike have expressed concern that the line between 'building materials' and 'fixtures' is a hard one to draw.³⁰ Presumably this is because the tests used by the courts have been ambiguous and inconsistently applied, resulting in contradictory results.³¹ The cases reveal that three general tests, based primarily on principles that already exist with respect to the law of fixtures, are being used

²⁷ S.O. 1983, c. 6, as am. 1983, c. 77.

²⁸ *E.g.*, the PMSI rule of s. 34(3) and the general priority rules contained in s. 35.

²⁹ *White & Summers, supra*, note 25 at 925.

³⁰ See *Collis v. Carew Lumber Co.* (1930), 65 O.L.R. 520 at 525 (C.A.) [hereinafter *Collis*]; *Campbell, supra*, note 23 at 58. Similar expressions of concern have also been made by commentators in the United States. See, *e.g.*, Gilmore, *supra*, note 11 at 812-14; K.J. Jurek, "Making the UCC's Fixture Section More Workable" [1971] U. Ill. L.F. 682 at 684.

³¹ See, *e.g.*, *Montreal Trust Co. v. Goldaire Rentals Ltd* (1966), [1967] 1 O.R. 40 (H.C.) [hereinafter *Montreal Trust Co.*] and *Toronto-Dominion Bank v. A.V. Ventures Ltd* (1983), 44 B.C.L.R. 347 (S.C.) ruling that elevators are fixtures, and *Huron Fabricators Ltd v. Joseph Walker* (14 February 1966), (Ont. S.C.) [unreported] (discussed at length in *Montreal Trust Co.* at 52-53), Carscallen Co. Ct. J. holding that elevators are building materials, not fixtures.

in distinguishing building materials from fixtures:³² (1) the degree or relative permanence of the annexation of the chattel to the real estate;³³ (2) whether the chattel was adapted to or customized for the particular use being made of the real estate;³⁴ and (3) the objective intention of the parties to make a permanent annexation to the realty.³⁵ An additional factor is the amount of damage to the basic structure of the building that would be incurred by removing the object from the realty. This last factor, however, is generally not considered to be a separate test but another factor to be used in conjunction with one or more of the other tests.³⁶

This concern, however, need not persist if the courts are able to understand and correctly apply the overall purpose and intent of section 36. Although the PPSA does not define the term 'building materials',³⁷ subsection 36(4) can be used by the courts in conjunction with the

³² See *Alexander v. McGillivray* (1932), 41 O.W.N. 406 at 408 (H.C.) (quoted and approved in *Charles A. Hare Ltd*, *supra*, note 8 at 97-98) where Assistant Master Lennox stated that in determining what is a building material "similar principles must be applied as in dealing with the question of fixtures. The degree and the object of the annexation must be considered. No doubt the distinction here should not be so finely drawn as in the case of fixtures, but the underlying principle is the same." But see *Montreal Trust Co.*, *ibid.* at 52 where MacRae Co. Ct. J. questions this approach.

³³ *Alexander v. McGillivray*, *ibid.* at 408; *Montreal Trust Co.*, *ibid.* at 55; *Charles A. Hare Ltd*, *ibid.* at 99; *Leslie & Palmer Co. v. Hydrogrowers Corp.*, *supra*, note 8 at 295; *Manning*, *supra*, note 8 at 73; *Re Patterson* (1969), 12 C.B.R. (N.S.) 251 at 253-54 (Ont. S.C.); *Agricultural Development Board v. De Laval Co., Ltd and Brown* (1925), 58 O.L.R. 35 at 38 (H.C.).

³⁴ *Collis*, *supra*, note 30; *Rockett Lumber and Building Supplies Ltd v. Papageorgiou* (1979), 30 C.B.R. (N.S.) 183 at 187-88 (Ont. Co. Ct.) [hereinafter *Rockett*] (thermos windows constructed with aluminum frames custom-made for a building and thus could not be used elsewhere unless disassembled and recycled).

³⁵ *Alexander v. McGillivray*, *supra*, note 32 at 408.

³⁶ *Montreal Trust Co.*, *supra*, note 31 at 48; *Collis*, *supra*, note 30; *Charles A. Hare Ltd*, *supra*, note 8 at 99; *Manning*, *supra*, note 8 at 73.

³⁷ Ontario courts have defined building materials to be "a material which becomes, or is intended to become, incorporated in a structure as an integral part of the structure": *Montreal Trust Co.*, *ibid.* at 55. See also *Alexander v. McGillivray*, *supra*, note 32 at 408 where Assistant Master Lennox said that 'building materials' are "integral parts of the whole construction, as compared with other articles which are mere adjuncts or appendages." Therefore, he continued,

[i]n determining what is building material it is necessary to consider the entire construction. Certain equipment that by itself would appear to come under the classification of a chattel, may in the general construction of a building become so closely interlinked and identified with other materials generally described as building material, that they must for all practical purposes be considered as building materials, within the meaning of s. 8 [of the *Conditional Sales Act*, R.S.O. 1927, c. 165].

See also *Rockett*, *supra*, note 34 at 186 and *Charles A. Hare Ltd*, *ibid.* at 99, which applied the reasoning of Assistant Master Lennox.

Section 1(d) of the Saskatchewan PPSA, *supra*, note 10, however, defines 'building materials' using a single test based upon the extent and type of damage caused by severing the goods from the building.

common-law tests above to assist in delineating the outer limits of this category. Section 36(4) provides that when a party with a security interest in a fixture has priority over the claim of a person having an interest in the real property, the secured party may on the debtor's default remove the collateral from the real estate. The secured party, however, must reimburse the encumbrancer or owner of the real property, other than the debtor, for the cost of repairing any physical injury to the realty caused by the removal. It is thought that this cost plus the expense of removal will deter removal of any goods whose value when removed would not exceed those costs. Therefore, practical economic considerations would preclude removals that would disrupt the building too much. Professor Hawkland has explained the relationship between the line separating 'fixtures' and 'pure realty' and Article 9-313(5), the equivalent of section 36(4), as follows:

While this class ['fixtures'] is difficult to define metaphysically, the draftsmen thought they could do it economically by stating that any chattel, except those falling clearly in [the 'pure realty' class], could be removed by the conditional seller regardless of material injury to the real estate claimant, if the fixture financier would reimburse the real estate claimant, other than the debtor, for the damage to the real property caused by the removal. Bricks incorporated into a building could not be removed under any circumstance . . . but what about an air conditioner or a furnace? It was thought that considerations of economics would prevent a conditional seller from effecting removal if these items were so much a part of the building that the physical damage to the structure would offset the gain of removal. On the other hand, *if this economic situation did not deter removal, that was proof positive that an item was really a fixture that could be taken*, with reimbursement for physical damage to the real property, by the chattel financier against nonprotected realty interests.³⁸

B. *Pure Personality Versus Fixtures*

Another major problem in this area is defining the line that distinguishes 'pure personality' from 'fixtures'. It is this line, to which section 36 in no way addresses itself, that will prove more difficult if

³⁸ W.D. Hawkland, "The Proposed Amendments to Article 9 of the UCC — Part 3: Fixtures" (1972) 77 Comm. L.J. 43 at 45. It appears that some courts have comprehended the scheme and plan of the fixture section. See, e.g., *Dry Dock Savings Bank v. De Georgio*, (1969), 305 N.Y.S. 2d 73 (Sup. Ct.), which held that aluminum siding on a house was a fixture and could therefore be removed by the fixture financier. Although the decision was questionable, the court showed a clear understanding of § 9-313, the model for s. 36 of the *PPSA*. In rendering its decision the court stated (at 75) that

the inquiry made now is different from that made formerly and so is the remedy. First you must decide whether the security holder's goods are like lumber and bricks. If they are, he has no lien and that is an end of the matter. If they are not, he has a superior lien, but not on the proceeds of the sale. He merely has the right to remove the goods after posting security to repair any damage.

the relevant pre-PPSA law does not recognize a tripartite division of property as does the PPSA. In fact, it seems to have been suggested in some literature that the Anglo-Canadian common-law position on fixtures does not recognize the PPSA's tripartite division of property.³⁹ Rather, in these jurisdictions the term 'fixtures' is used to express a legal conclusion and is not used to describe a special class of property annexed to the real estate.⁴⁰ Consequently, such a classification would make it conceptually impossible for any interest of a personal property character to co-exist with real property interests in the same goods. For example, if a suit arose between a chattel financier and the land mortgagee, the critical question would be whether the goods had become so affixed or annexed to the freehold as to become fixtures. If they had, there could be no chattel interest in the goods, which would have become part of the freehold, and the validity of the real property claim would be established.⁴¹ On the other hand, if the court concluded that the goods were not fixtures, then there could be no real property interest in them and the validity of the chattel interest would be established.

It has, therefore, been suggested that section 36 will be unworkable in these jurisdictions because under the PPSA, in contrast to the pre-

³⁹ See, e.g., H. Broom, *A Selection of Legal Maxims: Classified and Illustrated*, 10th ed. by R.H. Kersley (Philadelphia: T. & J.W. Johnson, 1939) at 262-63, 271; R.D. Niles, "The Rationale of the Law of Fixtures: English Cases" (1933-34) 11 N.Y.U.L.Q.R. 560 at 561 where the author stated: "The English view seems to be that the fixture, whether attached by the tenant or the owner is, while in place, owned by the owner of the land and has the legal characteristics of real property." See for support of this principle *Argles v. McMath* (1894), 26 O.R. 224 at 226, aff'd 23 O.A.R. 44; *Bain v. Brand* (1876), 1 App. Cas. 762 at 772 (H.L.); *Alway v. Anderson* (1848), 5 U.C.Q.B. 34 at 41 (C.A.). See also Manning, *supra*, note 23, but note the discussion of the rights of conditional vendors at 350-53. See also Oosterhoff & Rayner, *supra*, note 23, but note the discussion of the rights of conditional vendors at 1064. For literature that expressly rejects this conclusion, see McLaren I, *supra*, note 8 at § 6.03[2][b]; McLaren II, *supra*, note 8 at 239-40. See also notes 44-53, *infra* and accompanying text.

⁴⁰ This view of fixtures was in accordance with the ancient maxim, *quicquid plantatur solo, solo cedit*, which means "whatever is affixed to the soil belongs to the soil."

⁴¹ *Hobson v. Gorringe* (1896), [1897] 1 Ch. 182 (C.A.); *Reynolds v. Ashby* (1904), [1904] A.C. 466 (H.L.). In harmony with the English position, see *Hoppe v. Manners* (1931), 66 O.L.R. 587 at 592 where the Court of Appeal said that "[o]nce a chattel is attached to the realty in such a way as to become a fixture, then it is land and no longer a chattel." See also *Seeley v. Caldwell* (1908), 18 O.L.R. 472, 12 O.W.R. 1245 (H.C.). This principle has also been followed in other Canadian provinces. In Manitoba, see *Andrews v. Brown* (1909), 19 Man. R. 4 (C.A.) overruling two earlier decisions, *Waterous Engine Works Co. v. Henry* (1884), 2 Man. R. 169 (Q.B.) and *The Vulcan Iron Works Co. v. The Rapid City Farmers' Elevator Co.* (1894), 9 Man. R. 577 (Full Court), which upheld the rights of conditional vendors to remove their fixtures. In Saskatchewan, see *Cockshutt Plow Co. v. McLoughry* (1909), 2 Sask. L.R. 259 (S.C.); *Berlin Interior Hardwood Co. v. Colonial Investment and Loan Co.* (1918), 38 D.L.R. 643 (S.C.). In Alberta, see *D'Auigney v. Brunswick-Balke Collender Co.* (1917), [1917] 1 W.W.R. 1331 (S.C.). In British Columbia, see *Haywood & Dodds v. Lim Bang* (1914), 17 D.L.R. 760 (C.A.); *Welch v. General Refrigeration Ltd* (1929), [1930] 2 D.L.R. 672 (S.C.). In New Brunswick, see *Harrison v. Nespisquit Lumber Co.* (1911), 41 N.B.R. 1 (S.C.).

PPSA common-law position, a court must recognize the possibility of conflicting real and personal property interests in the same goods and resolve the conflicts by way of the priority rules in section 36. The practical implication of this is that lawyers and courts in such jurisdictions will get only limited guidance from pre-PPSA cases.⁴² While the pre-Act law may be useful in classifying the collateral as pure personalty or as pure realty, it will not be precise enough to help in distinguishing between a collateral that is pure personalty and one having both real and personal property characteristics.⁴³

However, there are a number of reasons that lead the author to believe that the situation is not all that bad. In Ontario and in most other Canadian jurisdictions, the common-law position has been modified significantly by conditional sales legislation or more recently by personal property security legislation.⁴⁴ By the *Conditional Sales Acts* or similar legislation of most of the jurisdictions, the seller retains rights in the goods (excluding building materials) even though they have become affixed to the realty. However, the owner of the realty, or any purchaser, mortgagee, or other encumbrancer, is given the right, as against the seller,

⁴² Many American commentators have made similar remarks about the relevance of pre-1962 Code cases. See, e.g., Coogan 1B, *supra*, note 11 at §§ 16.06, 17.09, 17.13, 17.14; C.D. Berry, "Priority Conflicts Between Fixture Secured Creditors and Real Estate Claimants" (1976-77) 7 Mem. St. U.L. Rev. 209 at 225-26; Adams, *supra*, note 7 at 838-41; Gilmore, *supra*, note 8 at 1395; but cf. Gilmore, *supra*, note 11 at 815 where upon further reflection the author did an about face.

⁴³ For instance, one who finances bowling alleys should not rely on a case like *Re Davis* (1953), [1954] O.W.N. 187 at 190 (H.C.), which held that a bowling alley was personal property. Yet the financer could under the PPSA rely on that case for the holding that a bowling alley is at least not realty. Similarly, a case like *Andrews v. Brown*, *supra*, note 41, which held that furnaces are realty, should not cause a financer to be reluctant to hold a security interest in furnaces as fixtures. Assuming that neither the bowling alley nor the furnace is classified as building material, both should be fixtures under the PPSA. See, e.g., *Collis*, *supra*, note 30, where the Ontario Court of Appeal held that a furnace was a fixture for the purposes of the *Conditional Sales Act*, R.S.O. 1927, c. 165, s. 2(3), which implicitly recognized a tripartite division of property when a conditional seller was involved. See also notes 52 & 53, *infra* and accompanying text; *Manning*, *supra*, note 8, where Monnin C.J.M. for the majority stated in *obiter* (at 73-74) that the gas water heater and furnace were fixtures but that the ducts, bonnets, eavestroughing, and gas pipes had become so incorporated into the dwelling that they had become building materials and were outside the scope of s. 36 of the Manitoba PPSA. *Contra* in a separate and concurring judgment, O'Sullivan J.A. stated in *obiter* (at 78):

There are many types of fixtures and special laws regarding some of them. But I have no doubt that in this country a furnace and water heater are regarded as part of a house which on a transfer passes under a Torrens transfer. I have no doubt that under the Torrens system a furnace and a water heater intended to be installed on a permanent basis is part of the land within the meaning of the [*Real Property*] Act.

⁴⁴ *Supra*, note 10.

to retain the goods upon payment of the amount owing on them.⁴⁵ This exception to the general approach with respect to fixtures is premised on the absence of any reliance interest on the part of the real estate interest. For example, if the fixture party is permitted to retrieve the fixture, the security of the realty interest will not be diminished. Conversely, if the fixture financier does not prevail, then the real estate interest will be unjustly enriched. In other words, because the fixture financiers (usually purchase money creditors) add new value to the real estate, their credentials have evoked extensive protection in Ontario and in other jurisdictions.⁴⁶

Therefore, because the initial common-law position on fixtures has been subject to constant modifications in light of changing social and economic conditions, three views are possible in those jurisdictions having similar conditional sales legislation.⁴⁷ First, the general rule is still that

⁴⁵ At one time, there were seven jurisdictions that had enacted legislation containing this special provision in respect of goods affixed to the realty. Subsequently, four jurisdictions have replaced their conditional sales legislation with personal property security legislation, *ibid*. The other three provinces are British Columbia (R.S.B.C. 1979, c. 373, ss 11(2), 16), New Brunswick (R.S.N.B. 1973, c. C-15, s. 17), and Newfoundland (R.S.N. 1970, c. 56, s. 14). The four common-law jurisdictions that do *not* contain a similar provision with respect to goods affixed to the real estate in their conditional sales legislation (*i.e.*, conditional sellers have only to register their agreement under the appropriate conditional sales register and not under any land registry system in order to maintain their rights against subsequent interests in the land) include Alberta (R.S.A. 1980, c. C-21), Nova Scotia (R.S.N.S. 1967, c. 48), Prince Edward Island (R.S.P.E.I. 1974, c. C-16), and Northwest Territories (R.O.N.W.T. 1974, c. C-9, as am. 1980 (2d Sess.), c. 7). For a discussion of the relevant provisions with respect to fixtures in the conditional sales legislation currently in place in Canada, see Oosterhoff & Rayner, *supra*, note 23 at 1064-67.

⁴⁶ In fact, the early common-law position in Ontario generally upheld the rights of conditional vendors to remove their fixtures. See, *e.g.*, *Joseph Hall Manufacturing Co. v. Hazlitt* (1886), 11 O.A.R. 749 at 751, 753, aff'd 8 O.R. 465 [hereinafter *Joseph Hall*]; *Stevens v. Barfoot* (1885), 13 O.A.R. 366 at 373; and *Polson v. Degeer* (1886), 12 O.R. 275 at 280 (C.A.), where all three courts recognized and approved a similar principle that "the affixing of the property of a stranger to the freehold of another did not operate to deprive the stranger of his right to the property when it could be removed without serious damage to the freehold" (*Polson v. Degeer, ibid.* at 280). See also *Thomas v. Inglis* (1885), 7 O.R. 588 (Ch. D.). But *cf. McDonald v. Weeks* (1860), 8 Gr. 297 (Ont.). After the English Court of Appeal decided against the chattel interests in *Hobson v. Gorringe, supra*, note 41, it was feared that the previous case law favouring the conditional seller would be reversed. Consequently, Ontario adopted legislation that gave the conditional seller some protection against real estate interests (see S.O. 1897, 60 Vict., c. 14, s. 80). That provision was further developed over the years — often in response to decisions like *Hoppe v. Mannors, supra*, note 41, which were clearly contrary to the history and plain intent of the legislation — and became, until its repeal, s. 10 of the *Conditional Sales Act, supra*, note 4.

It is also important to note that these Ontario cases have never been *expressly* overruled. *Accord* E.C. Fetzer, "The Ontario Conditional Sales Act: What are the rights of an unpaid seller, whose chattels have been affixed to realty" (1939) 17 Can. B. Rev. 583 at 584. But *cf. J.S. Ziegel, The Canadian Law of Conditional Sales and Hire-Purchase*, vol. 2 (Ph.D., University of London, 1962)[unpublished] at 519 n. 154, where the author suggests that "their authority has been much weakened" by *Haggart v. The Town of Brampton* (1897), 28 S.C.R. 174 (an appeal from Ontario) where the objective test of intention was affirmed and by numerous subsequent lower court decisions that appear to have assumed that the English position as enunciated in *Hobson v. Gorringe, ibid.*, represents the common law position in Ontario.

⁴⁷ McLaren I, *supra*, note 8, at § 6.03[2][b].

whatever is fixed to the freehold becomes part of it and is not capable of removal. Second, 'removable fixtures' such as 'trade fixtures' and 'tenants' fixtures' are one exception to the general rule. They are annexed to the land for the purposes of trade, domestic convenience, or ornamentation in so permanent a manner as to become part of the land,⁴⁸ but the tenants who erected them are entitled to remove them during the term of the tenancy⁴⁹ or after its expiration if they remain in possession under circumstances that entitle them to consider themselves as tenants,⁵⁰ provided that the removal of the fixtures will not cause substantial damage to the freehold.⁵¹ Third, chattels sold by conditional sellers who have complied with the *Conditional Sales Act* are a second exception. Despite affixation to the real estate, these chattels retain their discrete character so that the conditional seller can prevail over the real estate interests.⁵² It would therefore appear that, in certain circumstances, a tripartite division of property is recognized. Accordingly, courts in these jurisdictions should have little trouble in adjusting to personal property security legislation that simply deals with secured parties generally.⁵³

⁴⁸ *Bain v. Brand*, *supra*, note 39 at 770; *Holland v. Hodgson* (1872), L.R. 7 C.P. 328 at 333; *Re De Falbe* (1900), [1901] 1 Ch. 523 at 535, *aff'd (sub nom. Leigh v. Taylor)* (1902), [1902] A.C. 157 (H.L.). See also Manning, *supra*, note 23 at 321-23; Rhodes, *supra*, note 23 at s. 13:3 and the cases cited therein.

⁴⁹ *Veterans Manufacturing and Supply Co. v. Harris* (1920), 19 O.W.N. 226 (C.A.). See also Oosterhoff & Rayner, *supra*, note 23 at 1049 and the cases cited therein.

⁵⁰ *Cameron v. Hunter* (1873), 34 U.C.Q.B. 121 at 125 (C.A.). See also Oosterhoff & Rayner, *ibid.* at 1050 and cases cited therein.

⁵¹ *Cartwright v. Herring* (1904), 3 O.W.R. 511 at 512 (Trial Ct.); *Hughes v. Towers* (1865), 16 U.C.C.P. 287 at 296; *Liscombe Falls Gold Mining Co. v. Bishop* (1905), 35 S.C.R. 539. See also Rhodes, *supra*, note 23 at s. 13:3:2 and cases cited therein.

⁵² See, e.g., *Collis*, *supra*, note 30 at 524 where Mr. Justice Middleton held that when a chattel has become a fixture, the section of the [*Conditional Sales*] Act governing the rights of the parties is s. 8, and, assuming in other respects a valid conditional sale, the purchaser of the land is given the right to retain the fixture upon payment of the amount due. Otherwise, upon the occurrence of default, the seller may remove the fixture as fully and freely as if it had never been affixed to the land.

See also *Murphy Wall Bed Co. of Detroit v. Levin* (1925), 57 O.L.R. 105 at 108 (C.A.) [hereinafter *Murphy Wall Bed Co.*] (vendor has a right to remove beds affixed to a building that could be removed without causing injury to the building), where Ferguson J.A. referred to fixtures as meaning "something affixed as an accessory to the house rather than to something which forms part of the structure or house itself." See also *Goldie & McCulloch Co. v. Town of Uxbridge* (1909), 13 O.W.R. 969 (S.C.) (machinery sold under conditional sales agreement, vendor entitled to enforce rights under the agreement notwithstanding the fact that the machinery was affixed to the realty and that the realty would be damaged by its removal). For more recent cases, see *Pape v. Edfield Holdings Ltd* (1967), [1968] 1 O.R. 369 at 372 (S.C.O. Master's Chambers); *Montreal Trust Co.*, *supra*, note 31; *Plaza Equities Ltd v. Bank of Nova Scotia* (1978), 84 D.L.R. (3d) 609 (Alta. S.C.T.D.) [hereinafter *Plaza Equities Ltd*]; and *Stage Inns (Cranbrook) Ltd v. Standard Metal Products Ltd* (1977), 5 B.C.L.R. 140 (S.C.), *aff'd* (1978), 17 B.C.L.R. 1 (C.A.), leave to appeal to S.C.C. refused [1979] 1 S.C.R. xiii.

⁵³ See *Cormier*, *supra*, note 8 at 170.

Even in those jurisdictions where the prior law would not be based on this classification,⁵⁴ it does not follow that a fixture provision like section 36 will be impotent. The problem in these jurisdictions might be resolved by construing such a provision in the context of the general law of fixtures. The rights of third parties not having an interest in the land (for example, conditional sellers) are but one of the many specific problems dealt with in fixture cases.⁵⁵ A fixture section in personal property security legislation deals only with the problem of priorities. It would therefore be reasonable to assume that the fixture section supercedes the general law of fixtures only with respect to priorities and leaves the rest unchanged.⁵⁶ In other words, the courts should deal with the classification problem by relying on the common law; the priority problem can be determined by applying the fixture section in the personal property security legislation. Such a reading parallels the Canadian courts' position toward their respective conditional sales legislation; such legislation had no effect on the law of fixtures outside of the priority area but fundamentally altered the law in that area.⁵⁷

There would, however, seem to be a serious problem with this approach. As stated earlier,⁵⁸ in cases dealing with the rights of conditional vendors and other third parties, the concept of fixtures as a separate and distinct class of property is vigorously denied in these provinces; the term 'fixtures' is used simply to express a legal conclusion. Although the reasoning in the cases appears to involve a two-step process — first classifying and then deciding the victor — in reality classification and decision are one process. Because the courts in these provinces usually

⁵⁴ See note 45, *supra*, for those jurisdictions which seem to have only a two-category classification of property; that is, the question of whether the chattel has become a fixture is immaterial to the determination of the rights of the competing parties.

⁵⁵ Fixture law problems can be divided into four major categories: (1) owners of the fixtures install them on their realty and transfer or mortgage the realty; (2) owners of the fixtures annex them to someone else's realty in which they have some interest as, for example, tenants or licensees, giving rise to problems involving trade or tenants' fixtures; (3) third parties not having an interest in the land own the fixture or have a security interest in the fixture — the classic fixture priority problem; and (4) cases involving claims for insurance, assessment matters, and the like. *Cf* Manning, *supra*, note 23 at 301.

⁵⁶ Gordon, *supra*, note 12 at 664.

⁵⁷ See, e.g., *Crane v. Hoffman* (1916), 27 D.L.R. 592 at 597 (Ont. C.A.), Garrow J.A.; *Plaza Equities Ltd*, *supra*, note 52 at 634, where McDonald J. said that "[e]ven if the mobile home were a fixture at common law, so that the mortgagee of the land would have become entitled to it, the *Conditional Sales Act* may have the effect of altering the situation." See also a similar approach taken by American courts from minority rule states (that is, states that recognized only two types of property — personalty and realty) when s.7 of the *Uniform Conditional Sales Act*, the predecessor to the 1962 *Code*, came into effect. For example, in *People's Saving & Trust Co. v. Munsert* (1933), 212 Wis. 449 at 453, the court said that the priority dispute is "not ruled by the law of fixtures but by the law of conditional sales contracts and consequently the well-established common law applicable to fixtures has little to do with this controversy."

⁵⁸ See text accompanying note 40, *supra*.

prefer the real estate interest, they classify the conditional vendor's chattel, which has been annexed to the land, as real estate.

Therefore, a search of such cases is necessarily circular and worthless in assisting the courts to solve the classification problem. Moreover, it gives no effect to the purpose of a fixture section: to protect the rights of conditional sellers and other secured parties as against persons with an interest in the real estate.

Obviously, such a state of affairs must be avoided. Since the classification of objects as removable or irremovable fixtures is not necessarily the same under the various branches of fixture law,⁵⁹ courts should, in dealing with the classification problem, avail themselves of a branch of fixture law that best gives effect to the fixture section. The branch that determines whether the fixture would pass to a purchaser, grantee, or mortgagee of the real estate in the absence of an express provision in the deed, grant, or mortgage would appear to be the most desirable choice.⁶⁰

Accordingly, before deciding the priority issue, the courts should search for cases under this branch of fixture law in order to resolve the classification issue. If the investigation determines that the alleged fixture would not pass to the mortgagee or purchaser, the fixture section would not be applied because the common law has indicated that the

⁵⁹ In cases arising between tenant and landlord, the courts have generally held that the objects at issue are removable by the tenant: *Clark v. Brager*, *supra*, note 21 (electrical lighting, elevator, and hot air furnaces); *Howell v. The Listowell Rink and Park Company* (1887), 13 O.R. 476 at 491-92 (C.A.) (hardwood floor laid down for roller skating); *Dundas v. Osmont* (1907), 6 W.L.R. 86 at 88 (N.W.T.C.A.) (stair pads and *dictum* with respect to ordinary carpet tacked down to prevent it from slipping); *Argles v. McMath*, *supra*, note 39 (awnings, shelving, inner office, mirror, gas fixtures, and brass windows); *Devine v. Callery* (1917), 40 O.L.R. 505 (C.A.) (wooden house); *Blower and Sedens v. Workers' Compensation Board* (1983), 50 A.R. 66 (Q.B.) (crane with two-ton lifting capacity on a runway system bolted to the ceiling and floor of the building); *New Zealand Government Property Corporation v. H.M. & S. Ltd* (1982), [1982] Q.B. 1145 (C.A.) (theatre seats). In contrast, when the dispute is between a grantor and grantee, mortgagor and mortgagee, or vendor and purchaser, the courts have held the same object or substantially similar objects to be realty and thus not removable: *Stack v. T. Eaton Co.* (1902), 4 O.L.R. 335 (C.A.) (gas and electric light chandeliers and shelving); *Fess Oil Burners Ltd v. Mutual Investments Ltd* (1932), [1932] O.R. 203 (C.A.) (oil burner to heat premises); *LaSalle Recreations*, *supra*, note 23 (carpets with rubber undercushions held in place with hooks); *Dorey v. Gray* (1906), 42 N.S.R. 259 (C.A.) (storm windows and storm doors); *Ground Engineering Ltd v. Agra Industries Limited, B.B. Torchinsky & Associates Ltd and The H.A. Roberts Group Ltd* (1977), [1977] 6 W.W.R. 598 (Sask. Q.B.) (shelving, cupboards, counters, bookcases, a drying oven, an exhaust fan, and drapery rods); *Miles v. Ankatell* (1898), 25 O.A.R. 458 (C.A.) (a small wooden building); *LeBlanc v. Farm Credit Corp. of Canada* (1985), 64 N.B.R. (2d) 337 (Q.B.) (silos); *Lahey v. Queenston Quarry Co. Limited* (1916), 11 O.W.N. 18 (H.C.), *aff'd* 11 O.W.N. 120 (C.A.) (a derrick in a gravel pit); *Vaudeville Electric Cinema, Ltd v. Muriset* (1922), [1923] 2 Ch. 74 (theatre seats).

⁶⁰ The only other two possibilities are the last two branches referred to in note 55, *supra*. They deal with trade or tenants' fixtures, and the taxation and insuring of fixtures, respectively. Both are unsatisfactory alternatives. Trade or tenants' fixtures are often viewed as exceptions to the general principles of fixture law (see notes 154 to 157, *infra* and accompanying text). With respect to the last branch, not only are there fewer cases but often these decisions are based on statutory definitions of the term 'fixtures'.

alleged fixture is pure personalty; that is, real estate interests should not regard themselves as having any expectation interest in the fixture. On the other hand, if the common law determines that the fixtures would pass to the mortgagee or purchaser automatically as part of the real estate, then these real estate parties have an expectation interest that must be accounted for if a fixture financier's security interest exists. At this point, the priority rules in the fixture section are triggered in order to resolve the dispute between the competing parties.

Although the cases tend to label fixtures as real estate, including in this term both fixtures and building materials, the label is of little importance. It is usually apparent from the facts of the case which line the court is trying to delineate: pure personalty from fixtures or fixtures from building materials. If a court knows that the sole issue being decided is whether the chattel is pure personalty or a fixture, then it is not concerned with the fixture's ultimate classification under the common law. All a court needs to know before applying the priority rules in the fixture section is whether the person holding the interest in the real estate has an expectation interest in the article that is alleged to have become a fixture.⁶¹

C. Summary

Even though the term 'fixtures' is not defined in the PPSA, the Act does envision a tripartite classification of property with an intermediate class, fixtures, being bounded by pure realty on one side and pure personalty on the other. With respect to separating pure realty from fixtures, practical economic considerations, the common-law tests that

⁶¹ In determining whether a given chattel has or has not become a fixture, courts have generally looked at the degree of annexation (*i.e.*, the nature of the article and the mode of the annexation) and the object of the annexation (*i.e.*, the circumstances under which it was annexed, the purpose to be served, and the position of the rival claimants to the articles in dispute) (see, *e.g.*, *Reynolds v. Ashby*, *supra*, note 41 at 474; *Holland v. Hodgson* (1982), L.R. 7 C.P. 328 at 334, Lord Blackburn; *Haggert v. The Town of Brampton*, *supra*, note 46 at 180). The courts rarely speak of the mortgagee's or purchaser's expectation interest but these tests are in reality indicators of their expectation interest. As Mr. Justice Stevenson correctly noted in *Amic Mortgage Investment Corp. v. Investors Group Trust Co. Ltd* (1985), 37 R.P.R. 56 at 60 (Alta. C.A.):

the objective determination of what is and is not a fixture accords with commercial reality. *Holland v. Hodgson* depends not on agreement but on objectively determined intention. The purchaser of land, a mortgagee of land, a proposed mortgagee or purchaser of chattels may be *expected* [emphasis added] to rely on appearances, a factor reflected in Lord Blackburn's remark [at 335] "... if the intention is *apparent* [emphasis in original] to make the articles part of the land, they do become part of the land. . . ."

Moreover, with the recent trend in Anglo-Canadian fixture law toward emphasizing the purpose of the annexation rather than the degree of annexation (see, *e.g.*, *LaSalle Recreations*, *supra*, note 23; *Bank of Nova Scotia v. Mitz* (1979), 27 O.R. (2d) 250 (C.A.) (portable horse stalls that formed a barn were fixtures); *Hamp v. Bygrave* (1983), 266 E.G. 720 (Q.B.) (garden ornaments such as patio lights, stone urns, a stone statue, a stone ornament of Chinese origin, and a lead trough all found to be fixtures)), one can expect that decisions will be more consistent with a purchaser's or mortgagee's expectation interest than has been the case in the past.

already exist, and common sense should aid the courts in determining whether a chattel has become so incorporated into a structure as to have become building materials. With respect to distinguishing pure personalty from fixtures, most provinces have a statute that recognizes the *PPSA*'s classification of property in respect of the conditional seller. Thus, courts in these jurisdictions should have little difficulty in adjusting to the introduction of a fixture section. In those provinces where the *PPSA*'s classification is unfamiliar, another branch of the general law of fixtures can be used to solve the classification problem. If a priority problem should then arise, a court could apply the priority rules in the fixture section.

III. THE PERFECTION AND REAL ESTATE NOTIFICATION RULES

A. *How to Register a Security Interest in Fixtures*

Although the drafting is not as clear as one would like, the *PPSA* contemplates a uniform set of rules of perfection for security interests in all types of collateral and a second rule for additional fixture protection.⁶²

⁶² The drafting permits one to argue that the *Act* provides for mutually exclusive filings by creating one rule for security interests in goods and another for security interests in fixtures. Such an assertion is possible because s. 21 provides that a security interest is perfected when it has attached and all steps required for perfection have been completed. Perfection can be obtained by possession (s. 24) or by registering a financing statement in the prescribed form (ss 25 & 47(1)). (A third method of automatic but temporary perfection also exists but it does not apply to fixtures: s. 26.) Yet neither s. 24 nor s. 25 expressly includes fixtures in its list of collaterals. Only s. 54(1) explicitly refers to the registration of a security interest in fixtures. Accordingly, by filing a notice under s. 54, a fixture-secured party would perfect its interest in the fixtures.

There are, however, serious flaws in this reasoning. First, although ss 24 & 25 do not explicitly provide for the perfection of a security interest in the fixtures, they do state that possession or registration perfects a security interest in goods (ss 24(b) & 25(1)(b)). The definition of "goods" in s. 1(k) does not expressly refer to fixtures. Section 36(2), however, does refer to a "security interest that attaches to goods *after* they became fixtures." From this section, it is apparent that fixtures are part of the term "goods." Second, the wording in s. 54 does not state that registration of the notice perfects the security interest in the fixture; it merely constitutes actual notice of the security interest for the purposes of s. 36(3). Third, one commentator has suggested that registration is the residuary method of perfection for all types of collateral not specifically provided for in ss 24 or 26 (A.S. Abel, "Creation of a Security Interest with respect to Third Parties" in Law Society of Upper Canada, *Proceedings of a Program on the Personal Property Security Act* as cited in McLaren I, *supra*, note 8 at § 3.04). Therefore, if secured parties fail to perfect their fixture security interests, their interests will be subordinated to other secured parties having competing claims in the goods, as well as the persons described in s. 22.

This 'mutually exclusive filing' argument is not possible in the other *PPSA* jurisdictions (see McLaren I, *supra*, note 8 at §§ 20.08, 20.13 for a description of the rules as they pertain to the registration of fixtures in Manitoba, Saskatchewan, and the Yukon Territory) and will not be possible once the 1985 *Draft Act*, *supra*, note 15 is passed. The 1985 *Draft Act* eliminates the ambiguity by explicitly setting out a way of perfecting a security interest in fixtures. Fixtures are included in the definitions of both "goods" and "personal property." Therefore, a fixture security interest can be perfected by possession (s. 22(b) of the 1985 *Draft Act*) or by registration (s. 23 of the 1985 *Draft Act*).

A virtue of this scheme is that it separates the problem of perfection from the problem of priorities.⁶³ Fixture-secured parties must file a financing statement in the prescribed form in order to perfect their security interest in the fixtures.⁶⁴ Perfection protects a fixture financier's security interest against judgment creditors, a trustee in bankruptcy, and certain transferees for value.⁶⁵ No real estate filing is required for perfection but a real estate filing or notification under section 54(1)(a) is necessary as a condition of priority.⁶⁶ That is, if the fixture-secured party desires additional protection against the claims of subsequent real estate interests, then a second filing of a notice of the security interest in the proper land registry office is required.⁶⁷

Therefore, for those secured parties who are not worried about conflicts with holders of subsequent interests in the real estate,⁶⁸ the registration of a financing statement under section 47(1) should provide sufficient protection against the various parties in section 22. This is

⁶³ The 1962 Code, in contrast, did not separate the problem of perfection from the problem of priorities. Instead, mutually exclusive methods for perfecting security interests in fixtures and in other collaterals were established. Commentators in the United States have criticized this system of registration because it places secured parties in the unenviable position of having to determine whether the goods are "fixtures . . . [or] . . . may become fixtures." The decision is not always easy because, like fixture law in Canada, the law of fixtures in the United States is a "tangled web." Consequently, fixture financiers must either 'guess' as to the appropriate place of filing based on how they think a court will ultimately classify the collateral or file in all possible places. The reason for these precautions is that improper filing may cause fixture financiers to lose most of their priorities or even render their security interests worthless in the event of the debtor's bankruptcy. For a more detailed discussion of this problem and possible solutions to it, see Gilmore, *supra*, note 11 at 818-21, 834-36; Kripke, *supra*, note 11 at 55-57.

The 1972 Code alleviates the secured party's dilemma by removing some of the filing problems in the 1962 Code, but introduces new grounds for criticism. See Adams, *supra*, note 7 at 903-4, 910-13.

⁶⁴ Section 47(1). When the financing statement is filed under s. 47(1) of the *Act*, the financier need not indicate on the statement that the interest is or may become a fixture. If, however, fixture-secured parties want to record such information, then they can indicate on lines 13 to 15 of the financing statement that a fixture interest may arise. This is permitted by virtue of s. 3(3) of the *PPSA Regulations*, R.R.O. 1980, Reg. 749.

⁶⁵ Section 22. But see McLaren II, *supra*, note 8 at 266, where he suggests that a holder of an unperfected fixture security interest should prevail over a trustee in bankruptcy, despite the rule in s. 22(1)(a)(iii) because of the priority rule in s. 36. Professor McLaren's argument is examined later in this paper, see text accompanying notes 80 to 85, *infra*.

⁶⁶ *Accord Pers-Real Report*, *supra*, note 9 at 18. This scheme is also consistent with many situations in which a security interest, although perfected (and therefore good against s. 22 interests) may nevertheless be subordinated to other interests. For example, the additional requirements of s. 34(2), a PMSI in inventory, are conditions of priority that have nothing whatsoever to do with perfecting the security interests in inventory.

⁶⁷ A real estate filing or notification is clearly optional as evident from the wording of s. 54(1)(a). The relevant portions of that section read as follows: "A notice in the prescribed form *may* be registered in the proper land registry office, where, the collateral is or includes fixtures or goods that may become fixtures. . . ." [emphasis added].

⁶⁸ For example, if the fixture-secured parties believe that rising land values will ensure that the building and the fixtures together have or will have in the future sufficient value to cover all the debts, then they may feel that there is no need to file a real estate notice.

important since the acid test of any security interest is its invulnerability to attacks by the trustee in bankruptcy or by judgment creditors of the debtor.⁶⁹

The secured party is not, however, protected against a subsequent judgment creditor who files an execution against the real estate. Section 36(3)(b) provides that a fixture security interest is not good against creditors with liens on the real estate subsequently obtained by judicial proceedings unless real estate notification has occurred.⁷⁰ It is difficult to explain why these particular creditors are protected.⁷¹ They are not usually thought of as being "reliance" creditors.⁷² As well, the subsection produces an anomalous result. It gives more protection to an unsecured creditor than to a mortgagee when both the unsecured claim and the mortgage antedate the creation of the fixture security interest.⁷³ Presumably because there is no good reason for giving greater protection to these lien creditors, the Advisory Committee has recommended that this subsection be deleted when the *Act* is revised.⁷⁴

What protection does the real estate filing afford in the converse situation, when the fixture-secured party does not have a perfected security interest but has filed a notice of the security interest in the proper land registry office? As against real estate interests, a real estate filing should be effective. The *PPSA* attempts to provide a comprehensive system of rules to resolve conflicts between competing parties. Section 22 represents one set of rules that defines the consequences to secured parties of holding an unperfected security interest. The lack of perfection, however, does

⁶⁹ Coogan 1, *supra*, note 8 at § 3A.02[6].

⁷⁰ Section 36(3)(b) provides the following:

The security interest [sic] referred to in subsections (1) and (2) are subordinate to the interest of . . . a creditor with a lien on the real property subsequently obtained as a result of judicial process . . . if . . . the lien was obtained . . . without actual notice of the security interest.

A major interpretive problem posed by this section involves the time reference of the word "subsequently." The meaning of "subsequent" is considered later in this paper, see text accompanying notes 103 to 111, *infra*. Suffice it to say, a "lien . . . subsequently obtained" should be read as referring to the time the goods become fixtures. *Accord* Gilmore, *supra*, note 11 at 827.

⁷¹ American commentators also find it difficult to account for the protection afforded such creditors in the 1962 Code. Gilmore, *ibid.* at 826-27; Kripke, *supra*, note 11 at 59, where he describes § 9-313(4)(b) as being "unnecessary and unwise"; Adams, *supra*, note 7 at 849-50.

⁷² Kripke, *ibid.* at 59.

⁷³ For example, unsecured creditors who reduce their claim to judgment and acquire a judicial lien against the real estate before a fixture financier files a real estate notice prevail over even a perfected fixture security interest. Conversely, land mortgagees lose to subsequent fixture interests even if the latter have never perfected their security interest. See Gilmore, *supra*, note 11 at 826; Adams, *supra*, note 7 at 850 n. 53.

⁷⁴ See the Advisory Committee's commentary to this change in the 1984 Draft Act, *supra*, note 15 at 10, 54-55.

not affect the validity of the agreement;⁷⁵ it simply reduces the bundle of priority rights that exist independently of the perfection requirements and upon which a party with an unperfected interest can rely.⁷⁶ Section 36 is an example of a priority rule in which perfection is not a prerequisite. Thus, an unperfected security interest in a fixture is good against prior real estate interests.⁷⁷ Furthermore, as stated earlier,⁷⁸ a real estate filing is not a step towards perfection but rather a condition of priority. Accordingly, there is no reason to require a security interest to be perfected as a prerequisite to the operation of the rules that give fixture security interests priority over real estate interests when there has been a real estate filing under section 54(1).

Will a real estate filing alone be effective against a trustee in bankruptcy and the other persons listed in section 22? Most commentators conclude that a fixture-secured party's interest would not be good against the trustee in bankruptcy and the other persons who can take advantage of non-perfection.⁷⁹ Such a conclusion seems convincing given that a real estate notification is a condition of priority and not of perfection.

Professor McLaren, on the other hand, argues that notwithstanding section 22(1)(a)(iii), a fixture-secured party should, by virtue of the special priority rule in section 36, defeat a trustee in bankruptcy of a debtor who owns *only* real property.⁸⁰ This position, however, appears contrary

⁷⁵ Under the *PPSA*, a security interest is valid so long as the secured party has complied with all of the s. 10 formalities necessary for enforceability. In contrast, prior to the *PPSA*, a failure to have registered under the *Conditional Sales Act*, *supra*, note 4, s. 2(1), as am. S.O. 1972, c. 23, s. 1(1) or under the *Bills of Sale and Chattel Mortgages Act*, *supra*, note 4, s. 8 caused the transactions to become invalid.

⁷⁶ See Kripke, *supra*, note 11 at 59, where he states that while perfection or nonperfection is based on one set of rules and consequences stated or implied in Section 9-301 of the Code [comparable to s. 22 of the *PPSA*], there are *independently* various *priority* rules [emphasis in original], some of which apply between perfected interests and some of which apply between a perfected security interest and another kind of interest such as that of a buyer of chattels or real estate, an encumbrancer of real estate, or a non-contractual lien claimant. Section 9-313 [s. 36 of the *PPSA*] contains a set of priority rules of the latter type.

Accord McLaren II, *supra*, note 8 at 266.

⁷⁷ Section 36(1). Another such example is s. 37(1), where an unperfected security interest in an accession subordinates a prior interest in respect of the whole.

⁷⁸ See text accompanying notes 66 & 67, *supra*.

⁷⁹ See, e.g., Kripke, *supra*, note 11 at 59, where he explains how the above priority problem would be resolved under a registration system very much like the one currently in place in Ontario. See also *Pers-Real Report*, *supra*, note 9 at 20.

⁸⁰ McLaren II, *supra*, note 8 at 266. In his article, Professor McLaren appears to assert that a trustee in bankruptcy would lose whenever a fixture secured party holds a pre-affixation security interest. In a telephone conversation on March 6, 1986, he explained that his proposition was limited to those instances where the debtor owned only real property. In other words, he stated that an unperfected security interest in fixtures would not be good against the attacks of a trustee in bankruptcy if the debtor also owned personal property.

to the history and plain intent of this section and of a similar provision in the *Conditional Sales Act* that was enacted to statutorily protect a conditional seller from the courts' apparent willingness to disregard a vendor's interest in favour of third parties with an interest in the real estate, such as a land mortgagee.⁸¹ It was never intended that the section's priority rule should be used against the trustee in bankruptcy. Unlike a land mortgagee who gains title to the fixtures in the capacity of a holder with an interest in the real estate, the trustee in bankruptcy gains only the debtor's interest in the fixtures.⁸²

Second, the *PPSA* contemplates that only by filing a financing statement can a secured party protect its interest in a fixture from the attacks of the trustee in bankruptcy as well as the other parties listed in section 22.⁸³ Using section 36 to defeat the claims of a trustee in bankruptcy would simply cast aside what has been described by Professor McLaren as a fundamental policy of the *PPSA*; that is, "to encourage registration and perfection."⁸⁴

Furthermore, Professor McLaren's reason for not giving priority to trustees in bankruptcy over fixture-secured parties is not totally convincing. He believes that if trustees are able to claim priority before the fixtures are removed they will not be able to exercise the fixture-secured parties' rights of removal or be able to force them to exercise their rights. As a result, parties with a real estate interest will enjoy a windfall gain because most fixture-secured parties, when faced with this situation, will simply abandon their claims and never exercise their rights of removal.⁸⁵ While this may be true, giving priority to fixture financiers in this situation would in a sense provide a windfall gain to unperfected fixture-secured creditors who knew or ought to have known that an unperfected security interest would not protect them against those parties listed in section 22.

Therefore, a real estate filing should not protect the fixture-secured party's interest against the claims of those parties in section 22 who

⁸¹ See notes 44-46, *supra* and accompanying text.

⁸² See *Re Otto Grundman Implements Ltd* (1969), 9 D.L.R.(3d) 206 at 209 (Man. C.A.) where Mr. Justice Freedman held that "[a] trustee in bankruptcy stands in the shoes of the bankrupt, except where statutory provisions otherwise decree"; *Re Bellini Manufacturing and Importing Ltd* (1981), 1 P.P.S.A.C. 259 at 266 (Ont. C.A.). See also L. Duncan & J.S. Honsberger, *Bankruptcy in Canada*, 3d ed. (Toronto: Canadian Legal Authors, 1961) at 93-94, 285 and cases cited therein; L. W. Houlden & C.H. Morawetz, *Bankruptcy Law of Canada*, vol. 1 (Toronto: Carswell, loose-leaf, Release No. 22, June 1986) at F § 1 and cases cited therein.

⁸³ See text accompanying notes 62 to 65, *supra*.

⁸⁴ McLaren I, *supra*, note 8 at § 6.02[2][a][iii].

⁸⁵ McLaren II, *supra*, note 8 at 266.

can take advantage of nonperfection. If none of these parties are present in the dispute, then there is no reason for requiring perfection as a prerequisite to applying the rules in section 36 in favour of the fixture-secured party as against all real estate interests when a real estate notice has been properly filed.

B. *Formal Requirements for Perfection and Real Estate Notification: The Secured Party's Practical Difficulties*

Although the system of registration for fixtures generally works well, the current rules do contain a number of uncertainties threatening not only the naive and unsuspecting creditor but also the more sophisticated lending institution. Before fixture-secured parties can take advantage of a perfected security interest or a notice filed in the proper land registry office, they must satisfy the formalities contained in section 10. Otherwise, the security interest will not be enforceable "by or against a third party." The formal requirements for a non-possessory security interest in fixtures are: (1) an agreement creating a security interest; (2) the signature of the debtor; (3) a description of the collateral; and (4) a description of the land concerned.⁸⁶

In addition to the requirements in section 10, in order to properly complete and register a financing statement under section 47(1) and a real estate filing under section 54(1), a fixture-secured party must also provide: (5) the names and addresses of the debtor and the secured party; (6) if the debtor is an individual, his or her sex and birth date; (7) the classification of the collateral as consumer goods, inventory, equipment, or other; (8) if the collateral is classified as consumer goods, the principal amount secured and the date of maturity, if any; and (9) the signature of the secured party or the registered agent.⁸⁷ As well, proper filing of

⁸⁶ Sections 10(b) & 1(x).

⁸⁷ *PPSA Regulations*, R.R.O. 1980, Reg. 749, ss 3 & 14. Section 3(3) gives the fixture-secured party the option to indicate on lines 13 to 15 of the financing statement that a fixture interest does exist or may arise.

There is one other step — 'attachment' — required before the security interest will be perfected. Attachment occurs when all elements in s. 12(1) have taken place. The rights of the debtor in the collateral are then restricted by the rights of the secured party. Attachment is a term of art in the *PPSA*. In order to avoid confusion in this article, the words 'attachment' and 'attach' will be confined to their more technical meaning and will not be used to refer to the physical connection of a chattel with the realty. Instead, the terms 'affix', 'affixation', 'annex', and 'annexation' will be used in those instances where the chattel has become physically connected with the real estate. For a discussion of the concept of attachment, see McLaren I, *supra*, note 8 at § 2.01.

a real estate notice requires a registrable or legal description of the land upon which the goods are affixed or are going to be affixed.⁸⁸

Secured parties must satisfy all of these requirements if they desire to obtain the greatest protection with respect to the fixtures they secure.⁸⁹ Most of the formalities that fixture-secured parties must satisfy are common to other secured parties who wish to create a valid and perfected non-possessory security interest. Much has been written of the problems facing secured parties generally who want to take and perfect their security interests by registration.⁹⁰ The task facing fixture-secured parties, however, is even more difficult and occasionally impossible, because one of the prerequisites for creating an enforceable security interest in fixtures is an identification of the land to which the fixtures will be affixed. Moreover, a legal description of the land is required in order to file a real estate notice under section 54(1).

Providing a description of the land to which the fixtures will be attached is onerous because the *Act* does not define or indicate what will be an adequate "identification of the land concerned." Is a full-blown legal description required? Or is something less, like a street address, satisfactory? It is clear that the only description of land that will be sufficient for a real estate filing under section 54(1) is a legal one. In that instance, however, the rationale for requiring a full-blown legal description is obvious. The real estate notice is to be filed where all other encumbrances on the land are recorded, and the land registry system indexes according to a number determined by the legal description. Thus, the filing requirement is intended to tie the notice into the real estate indexing system to ensure that title searchers will acquire notice of security interests in fixtures in the course of a real estate title search. A similarly

⁸⁸ *Ibid.*, s. 24(1) and Form 1, O. Reg. 838/81, s. 2. In addition to the legal description, a real estate notice contains the name and address of the debtor and secured party, a brief description of the collateral, and the signature of the secured party. However, the secured party already has this information since, with the exception of the legal description, it was needed in order to register the financing statement. On whether a legal description of the land is required for the purpose of section 10, see text accompanying notes 91 & 92, *infra*.

⁸⁹ A secured party might have to satisfy additional requirements of form imposed by other statutes and referenced by the *PPSA*. For example, s. 17 of the *PPSA* provides that the *Sale of Goods Act*, R.S.O. 1980, c. 462 [hereinafter *SGA*] governs the sales aspects of a secured transaction. See also s. 68, which provides, in contrast to the general conflict rule of this section, that in the case of a conflict between the provisions of the *Consumer Protection Act*, R.S.O. 1980, c. 87 and those of the *PPSA*, the former prevails. For a brief discussion of those sections in the *Consumer Protection Act* that have an impact on the *PPSA*, see Ziegel & Geva, *supra*, note 25 at 981-82.

⁹⁰ See, e.g., J.S. Ziegel, "Recent and Prospective Developments in the Personal Property Security Law Area" (1985) 10 Can. Bus. L.J. at 154-59; W.S. Robertson, "Different Forms of Security Agreements" in D.E. Baird & F. Bennett, eds., *Handbook on the Personal Property Security Act* (Toronto: Insight Educational Services, 1982) at 21-24; E. B. Leonard, "Problems with the *PPSA*" in Baird & Bennett, *ibid.* at 127-31; and J.S. Ziegel, "PPSA Registration Problems" (1978-79) 3 Can. Bus. L.J. 222.

compelling argument, however, does not exist for requiring such an exacting description under section 10(b). American courts have interpreted a comparable section of the *1962 Code*⁹¹ as not requiring a legal description of the land.⁹² Those decisions, however, cannot automatically be transported to Ontario because the *1962 Code* also contains section 9-110, which is not found in the *PPSA*. That section provides that “[f]or the purposes of [Article 9], any description of personal property or real estate is sufficient, whether or not it is specific, if it reasonably identifies what is described.” One can only hope that Ontario courts will realize how unnecessary and overly exacting a demand requiring a legal description is upon fixture-secured parties (as well as other parties with an interest in crops, oil, gas, minerals, or timber) and will therefore, even in the absence of a section 9-110 guideline, follow the approach taken by American courts.

Even if Ontario courts do give a wide meaning to the word “identification,” such a construction will still not be wide enough for some secured parties. Occasionally, secured parties may know or have reason to believe that the goods will become fixtures but be unable to ascertain where they might be affixed. For example, this would occur when the debtor is a large business organization with real estate located in numerous counties throughout the province and the debtor has granted a security interest on *all* of a particular type of equipment that is or may be classified as fixtures. In such instances, the secured party’s dilemma is acute because if the security agreement fails to identify the lands upon which the goods are going to be affixed, then the secured party will not have a security interest that is enforceable “by or against a third party.”

Given that some secured parties could never or only with some difficulty satisfy this requirement, why then did the drafters of the *PPSA* include it in section 10(b)? It certainly does not encourage the commitment of new capital to the improvement of real estate and the modernization and expansion of industry. Moreover, the former *Conditional Sales Act* did not require, as a condition of validity, that the contract identify the related land when fixtures were involved in the transaction.⁹³ Similarly, a description of the land has not been necessary in the other *PPSA*

⁹¹ Section 9-203(1)(b).

⁹² See, e.g., *United States v. Big Z Warehouse* (1970), 7 U.C.C. Rep. 1061 at 1065 (S.D. Ga.); *Chanute Production Credit Association v. Weir Grain and Supply, Inc.* (1972), 499 P.2d 517 (Kan. S.C.). In both of these cases, the collateral in dispute was crops.

⁹³ Section 2(a).

jurisdictions.⁹⁴ The only explanation is that this is simply another example of a section taken blindly from the 1962 *Code* without the drafters realizing all of the implications of their action. Presumably realizing the dilemma the provision has created for some fixture-secured parties, the Advisory Committee has recommended that it be deleted in the next revision of the *PPSA*.⁹⁵

Nevertheless, the problem of registering in each county involved when an organization grants a security interest on all of its equipment of a particular type that may be classified as fixtures will still persist under the 1985 *Draft Act*. For those secured parties who are not worried about conflicts with holders of subsequent interests in the real estate, the inability to file a real estate notice will not be of any concern. For others who want to be protected against subsequent interests in the real estate, the *PPSA* registration system is simply not set up to accommodate their practical difficulties.⁹⁶

IV. CONSTRUCTION MORTGAGES

A. *The Problem and the Compromise*

Another problem in section 36 is the possible conflict between the construction mortgagee and the holder of a fixture security interest. The

⁹⁴ See s. 10(b) Manitoba *PPSA*; s. 10(1)(b) Saskatchewan *PPSA*; s. 10(1)(b) Yukon *PPSA*; *supra*, note 10.

⁹⁵ See 1985 *Draft Act*, *supra*, note 15 at 20.

⁹⁶ Other practical difficulties arise when the secured parties do not know how the debtor plans to use the goods and hence are unable to predict whether they will become fixtures; or when the debtor initially tells the secured party that the goods will remain chattels but later annexes them to the realty so they become fixtures unbeknownst to the secured party. If these secured parties want their already perfected security interests to be effective against the parties described in s. 36(3), then the secured parties must follow their debtors around to determine how the goods are actually used.

Moreover, clauses in security agreements stating that the debtor agrees that "the goods are not to be or become a fixture and are at all times to be and remain personal property" are only effective where the parties to the agreement are the only claimants. In such cases, their rights will be governed by their agreement (see, e.g., *Scarth v. The Ontario Power and Flat Company* (1894), 24 O.R. 446 (H.C.); *Herriott v. Cronin* (1935), [1935] 2 D.L.R. 637 at 639 (Man. C.A.); *Re Maple Leaf Coal Co. Ltd* (1951), [1951] 4 D.L.R. 210 (Alta. C.A.); *Publishers Holding Ltd v. Industrial Development Bank* (1974), [1974] 4 W.W.R. 440 at 442 (Man. Q.B.); see generally *Report on Landlord and Tenant Law*, *supra*, note 22 at 75, where the Ontario Law Reform Commission took the view that parties can, by agreement, alter their rights to fixtures and chattels). The intention to alter the rights to the articles, however, must be clearly manifested in the agreement by the use of clear and unambiguous words as opposed to general terms (see, e.g., *Oromocto Motor Inn Ltd v. Wilson* (1985), 38 R.P.R. 33 at 37 (N.B.C.A.)). As well, an agreement will not be effective against third parties (e.g., subsequent purchasers or mortgagees) who are without notice of the agreement (see, e.g., *Berlin Interior Hardwood Co. v. Colonial Investment and Loan Co.*, *supra*, note 41 at 646; *Canadian Bank of Commerce v. Lewis and Lewis* (1907), 12 B.C.R. 398 at 400 (Full Court); *Amic Mortgage Investment Corp. v. Investors Group Trust Co. Ltd*, *supra*, note 61 at 59, 61) unless the fixtures in dispute fall within the exception for 'tenants' fixtures' (see notes 160 to 167, *infra* and accompanying text).

drafters envisioned a situation in which a landowner borrows money in order to erect a building or some other improvement on the land. The lender receives a mortgage on the land before the construction begins. The construction mortgagee makes a commitment sufficient to ensure completion of the project. As a result, it is essential that the whole project, including materials and equipment, be free of liens superior to that of the mortgagee. Usually in larger loans the loan agreement expressly requires the owner-mortgagor to provide the lender with documentation to ensure that the work is progressing as expected, that the materials and equipment are free of security interests, and that there are sufficient funds available to complete the project.

Occasionally, however, the owner-mortgagor might obtain some needed materials and equipment on credit subject to purchase money security interests in favour of the suppliers. If the goods in question become fixtures when installed on the land, and if the chattel suppliers are given priority over the construction lender, the latter may be left with security insufficient to cover the loan.⁹⁷ On the other hand, if the fixture suppliers are subordinated to the construction lender, they will have donated their goods to feed the lender's security even though they have a strong equitable claim to the goods, at least until payment is made.⁹⁸

Pre-PPSA decisions in Ontario generally preserved a chattel supplier's encumbrances after the chattel became a fixture.⁹⁹ Section 36(1) of the PPSA reflects the continuation of this long-standing policy. The rationale underlying this priority is that 'new money' should prevail over 'old money' because the latter has not relied on the acquisition of the fixture as security. Therefore, the argument goes, old money should not be unjustly enriched at the expense of new money, which justifiably relies on the goods to secure their purchase price. This assumption is, however, specious where construction mortgagees are involved because they make their advances with the clear expectation that the advances will be secured by the new building and its fixtures. One can, therefore, argue that construction mortgagees have a stronger claim to priority than other holders of pre-affixation interests in the land because construction mortgagees can be considered to have a reliance interest in the fixtures.

The PPSA tries to reach a compromise between these two competing claims. If a construction-mortgagee advances money to enable the owner-mortgagor to purchase goods needed for the construction project

⁹⁷ F. Leary & P.L. Rucci, "Fixing Up the Fixture Section of the ucc" (1969) 42 Temp. L.Q. 355 at 397-98 n. 99.

⁹⁸ Adams, *supra*, note 7 at 852.

⁹⁹ See note 46, *supra* and accompanying text.

and, instead, the owner-mortgagor purchases the same goods (which will become fixtures once they are installed on the land) from suppliers on credit subject to a purchase money security interest, then the fixture supplier will prevail in a priority contest with the construction mortgagee by virtue of section 36(1).¹⁰⁰

On the other hand, if a construction mortgagee makes an advance after the fixtures have been affixed to the realty then under section 36(3)(c)¹⁰¹ the construction mortgagee will be given priority over the suppliers of the fixtures unless the fixture suppliers had filed notices of their security interests in the proper land registry office before the advance was made or the construction mortgagee knew of the security interest when the advance was made. This section, therefore, protects construction lenders from a danger against which they could not effectively guard — making an advance against materials and equipment affixed to the land without knowing that the goods are already secured by unknown and undiscoverable claims.¹⁰²

B. *Problems of Interpretation*

The use of overly broad and ambiguous wording in subsection 36(3)(c) will create a number of interpretive headaches for the courts. The three most serious problems inherent in this subsection are: (1) the meaning to be attached to the word “subsequent”; (2) the scope of the protection offered; and (3) the meaning that should be given to the words “contracted for.”

1. The meaning of “subsequent”

Although the general policies embodied in subsections 36(1) and (3) are clear enough, nowhere does the *Act* identify the point in time to which the advance must be “subsequent.” The problem arises because the time reference of subsection 36(3)(c) is vague when it speaks of “prior” encumbrances and “subsequent” advances. It is surprising that

¹⁰⁰ Section 36(1) provides the following: “Subject to subsection (3) of this section and notwithstanding subsection 34(3), a security interest that attached to goods before they became fixtures has priority as to the goods over the claim of any person who has an interest in the real property.”

¹⁰¹ Section 36(3)(c) provides that:

The security interest [sic] referred to in subsections (1) and (2) are subordinate to the interest of . . . a creditor with a prior encumbrance of record on the real property in respect of subsequent advances, if . . . the subsequent advance under the prior encumbrance was made or contracted for . . . without actual notice of the security interest.

¹⁰² Adams, *supra*, note 7 at 853.

the drafters of the *Act* were insensitive to this ambiguity given that the *Conditional Sales Act* expressly dealt with this problem.¹⁰³ Nevertheless, one knows that the event marking the time at which 'subsequentness' begins must be before a fixture supplier has registered a notice of the security interest in the proper land registry office, because only advances made before a fixture supplier has registered a real estate notification are entitled to priority under subsection 36(3)(c). That leaves two possible events that could mark the dividing line: when the security interest of the fixture holder attaches (almost always the time the sale is concluded between the seller of the fixture and the debtor); or when the fixture is affixed to the premises.¹⁰⁴

Most, if not all, commentators argue that no mortgagee can reasonably rely on a fixture as security until it has been affixed to the property.¹⁰⁵ This rationale was adopted in *House v. Long*,¹⁰⁶ a decision under the 1962 *Code*. That case involved, *inter alia*, the priority between a purchase money security interest and a construction mortgage. The court held that the critical time was when the goods became fixtures because only after that time could a prior mortgagee be induced by the owner-mortgagor to make additional advances.

The reasoning of the courts and commentators is persuasive because the choice of annexation as the event marking priority is consistent with the rationale suggested above as to how subsections 36(1) and (3)(c) should interact in striking a compromise between these competing parties.¹⁰⁷ Moreover, this would be consistent with the *Conditional Sales*

¹⁰³ Section 14(4) of the *Conditional Sales Act* provided that [w]here the goods have become affixed to the land or are fixtures and there is already registered against the land a mortgage or charge, all payments or advances made on the mortgage or charge *after the goods have become affixed or have become fixtures and before registration of notice of the contract* under this section have priority over the rights of the seller under the contract [emphasis added].

See also *Poloniato v. Regina Macaroni Holding Ltd* (1955), [1955] 4 D.L.R. 845 (Ont. H.C.). See also Rayner & McLaren, *supra*, note 23 at 180.

¹⁰⁴ White & Summers, *supra*, note 25 at 932.

¹⁰⁵ McLaren II, *supra*, note 8 at 256. A similar argument has also been made by commentators of the 1962 *Code*. See, e.g., Kripke, *supra*, note 11 at 72; Adams, *supra*, note 7 at 853; Gordon, *supra*, note 12 at 682-83; Coogan IB, *supra*, note 11 at § 17.04[1] n.18; S. Goodkin, "The Ambiguous Statutory Machinery Pertaining to Fixtures Under The Uniform Commercial Code: Whether the New 9-313 Provision Effectively Eliminates Prior Criticism of the Old 9-313" (1973) 27 Ark. L. Rev. 482 at 498-99. Professor Gilmore would also extend protection to those advances made after attachment but before the goods became fixtures if the mortgagee knew when the advance was made that the debtor was acquiring the goods with the intent to affix them to the land: Gilmore, *supra*, note 11 at 825-28.

¹⁰⁶ (1968), 244 Ark. 718. See also *Babson Credit Plan, Inc. v. Cordele Production Credit Association* (1978), 24 U.C.C. Rep. 437 (Ga. C.A.).

¹⁰⁷ See text accompanying notes 100 to 102, *supra*.

Act.¹⁰⁸ It would also be more consistent with a fixture seller's reasonable expectations and the business realities of selling such goods than any other interpretation.¹⁰⁹ For instance, if a mortgagee who made an advance after attachment but before installation was given priority under subsection 36(3)(c), then a secured seller of fixtures would have to file before or simultaneously with the sale. Therefore, fixture sellers could neither wait for installation nor benefit from the ten-day grace period that purchase money security sellers of non-fixture goods enjoy under section 34(3).¹¹⁰ The drafters of the *PPSA* could not have intended such a result. They were aware that requiring advance registrations in purchase-money transactions, particularly those involving the sale of consumer goods and commercial equipment, would be impracticable because such transactions are often not negotiated in advance. It is unrealistic to assume that a clerk can ensure that all the necessary legal documents are properly executed and registered before the goods are handed over to an important customer.¹¹¹

2. Who qualifies for protection?

A second interpretive problem concerns the scope of the protection offered. Although section 36(3)(c) is believed to be aimed primarily at construction mortgagees,¹¹² the terms of the section refer broadly to any "creditor with a prior encumbrance of record on the real property" who makes a "subsequent advance under the prior encumbrance."¹¹³ This subsection, therefore, can be used to give priority to any real estate mortgagee as long as the mortgage contains a valid future advance clause. The possibility therefore exists that the section may allow a mortgagee to win a priority contest against a fixture financier when the former has no reliance interest and the latter has all of the equities.¹¹⁴

¹⁰⁸ See note 103, *supra*.

¹⁰⁹ See, e.g., White & Summers, *supra*, note 25 at 833, where they state that sellers of fixtures generally "feel no pressing need to file [a real estate notification] before the goods are installed."

¹¹⁰ *Ibid.*

¹¹¹ See generally McLaren I, *supra*, note 8 at § 6.01[3][a][iii].

¹¹² See Adams, *supra*, note 7 at 851, 853; Kripke, *supra*, note 11 at 50-51.

¹¹³ The *Act* does not define "encumbrance." It would certainly include a mortgage or a charge on the real estate. What more might be covered within this term is purely conjecture. See, however, the *Mortgages Act*, R.S.O. 1980, c. 296, s. 1(b), which defines an "encumbrance" to include "a mortgage in fee or for a less estate, a trust for securing money, a lien, and a charge of a portion, annuity or other capital or annual sum." Professor Gilmore, who also questioned why the "encumbrance" should be "of record," said that it was simply an unexplained addition to the 1956 revision of Article 9-313: Gilmore, *supra*, note 11 at 828.

¹¹⁴ See, e.g., the hypothetical case in Gordon, *supra*, note 12 at 680.

3. The meaning of the phrase "contracted for"

Third, there is uncertainty as to how the courts are going to interpret the phrase "contracted for." In fact, if "contracted for" is given the broadest possible reading, the section might be interpreted as meaning that any advance made under a prior mortgage that contains a clause providing for future advances will have been "contracted for" from the time the mortgage was executed, regardless of when the advance is made. All advances made by the mortgagee will then be given priority over an intervening fixture security interest even though a notice of the security interest has been filed in the proper land registry office or the mortgagee has knowledge of it at the time the advance is made.

Surely, the fixture security interest should not be subordinated to future advances simply because the advances were "contracted for" before the goods were affixed to the realty. In fact, it is rather doubtful that an interpretation that would seriously undermine the long-standing policy in Ontario of protecting a fixture seller's encumbrance was intended by the drafters of the PPSA.¹¹⁵ Such a reading would also be at odds with the Anglo-Canadian common-law position that does not give priority to advances made under a first mortgage once the first mortgagee has received actual notice of a subsequent encumbrance.¹¹⁶ Finally, as a practical matter, it would become very difficult for someone who has an outstanding mortgage to purchase fixtures on credit because of the risks fixture sellers or financiers would have to assume in such situations.¹¹⁷

Why then are the words "contracted for" found in the section? Although a literal interpretation of "contracted for" goes too far from the fixture-secured party's point of view, 'made before real estate notification' does not seem to go far enough from the construction mortgagee's point of view. As was noted earlier,¹¹⁸ construction mortgagees deserve more protection than other holders of pre-affixation land interests because the former can be considered to have a reliance interest in the fixtures. Reconciling such conflicting claims is never an easy task.

¹¹⁵ On numerous occasions courts and commentators have referred to Ontario's long-standing policy. See, e.g., *Cober Elevator Manufacturing Co. v. Greenberg* (1942), [1942] 2 D.L.R. 791 (Ont. C.A.); *Dominion Lock Joint Pipe Co. v. York* (1929), [1929] 4 D.L.R. 806 at 808 (Ont. C.A.). See generally Fetzer, *supra*, note 46 at 583-86; J.J. Robinette, "Fixtures — Conditional Sale of Chattel — Ontario Land Titles Act" (1931) 9 Can. B. Rev. 381 at 382-83.

¹¹⁶ See, e.g., *Hopkinson v. Rolt* (1861), 9 H.L. Cas. 514, 11 E.R. 829; *Bradford Banking Co., Ltd v. Henry Briggs, Son & Co., Ltd* (1886), 12 App. Cas. 29 (H.L.); *Union Bank of Scotland v. National Bank of Scotland* (1886), 12 App. Cas. 53 (H.L. Scot.); *Pierce v. Canada Permanent Loan and Savings Co.* (1895), 25 O.R. 671 (C.A.); *Marshall-Wells v. Alliance Trust Company* (1920), [1920] 1 W.W.R. 907 at 912 (Alta. C.A.). This common law position has been codified in Ontario. See, s. 68 of the *Registry Act*, R.S.O. 1980, c. 445, as am. and s. 93(4) of the *Land Titles Act*, R.S.O. 1980, c. 230, as am.

¹¹⁷ Coogan 1B, *supra*, note 11 at § 17.05[1].

¹¹⁸ See text following note 99, *supra*.

The American case law on future advances, however, distinguishes between 'obligatory' and 'optional' future advance arrangements.¹¹⁹ In all probability, the "contracted for" provision, which was first added by the UCC's Editorial Committee in the 1956 revision of Article 9-313,¹²⁰ was intended to refer to only obligatory future advance arrangements;¹²¹ that is, mortgagees making an obligatory future advance are entitled to priority over intervening liens and encumbrances even though the mortgagees are aware of such intervening interests when they make the advance. An optional advance, in contrast, would only give the mortgagee priority when unaware of the intervening security interests. The rationale for this distinction seems to be that mortgagees who are contractually committed to make the advances have no means of protecting themselves, while in the case of optional advances, mortgagees can refuse to make the advances once they have become aware of the intervening security interests.¹²²

Assuming that "contracted for" is limited to obligatory advances, one can appreciate the aims of the revisers in trying to better balance the claims of these competing parties. There are, however, two potentially serious problems with this aim from a Canadian standpoint. The first one is of a more general nature, dealing with the uncertainty in application of the doctrine; the second is more specific to Canada, and concerns the appropriateness of the doctrine against a Canadian common-law background.¹²³

¹¹⁹ See generally G.E. Osborne, G.S. Nelson & D.A. Whitman, *Real Estate Finance Law* (St. Paul's Minn.: West Publishing, 1979) at § 12.7; L. Skipworth, "Should Construction Lenders Lose Out on Voluntary Advances If a Loan Turns Sour?" (1977) 5 Real Estate L.J. 221; B.E. Griffith & C.D. Kipp, "Mortgages to Secure Future Advances: Problems of Priority and the Doctrine of Economic Necessity" (1975) 46 Miss. L.J. 433 at 437-38; R. Kratovil & R.J. Werner, "Mortgages for Construction and the Lien Priorities Problem: The 'Unobligatory' Advance" (1974) 41 Tenn. L. Rev. 311 at 314; Coogan 1B, *supra*, note 11 at §§ 21.05-21.07; Gilmore, *supra*, note 11 at 916 n. 1, 925-31 and authorities cited therein. See also Annotation, 80 A.L.R.2d 179 at 191-96.

¹²⁰ Leary & Rucci, *supra*, note 97 at 403; Gilmore, *ibid.* at 828.

¹²¹ Gilmore, *ibid.* at 927-28; Adams, *supra*, note 7 at 854.

¹²² Gilmore, *ibid.* at 829, 927-28; Adams, *ibid.* at 854; Griffith & Kipp, *supra*, note 119 at 441-42.

¹²³ Professor Gilmore, *ibid.* at 926, argues that there is another problem with the obligatory and optional future advance distinction; it is conceptually invalid because a commitment to lend money can be breached without legal liability. He asserts as a general rule that a contract to lend money will not be specifically enforced. Therefore, no matter how bound lenders may be, a court will never order specific performance of the obligation to lend money. If this is so, then all advances are, in reality, optional. He further argues that no damages will be awarded against the lender. This argument is based on the view that if the borrower is unable to get a replacement loan or is only able to get one at a much higher rate of interest, the damages suffered by the borrower will not be recoverable because "they will be the result of the borrower's own deteriorated

a) *The obligatory–optional distinction*

On the surface, the distinction between an obligatory and an optional advance would seem to be a simple one to apply. If construction mortgagees are under no contractual obligation, but may elect to make additional advances, then such disbursements are optional future advances. On the other hand, if construction mortgagees desire that none of their advances be subordinated by any intervening liens or encumbrances, then they must make their advances pursuant to a contractual obligation.¹²⁴ Because any competent lawyer could draft a mortgage or construction loan agreement that read either way, one would naturally think that the courts would have no trouble in dealing with this problem. In fact, this doctrine has been severely criticized by all concerned parties in the United States. Not only do construction lenders and their title insurers despise it (for reasons which will become apparent later), but practitioners

credit standing." If Professor Gilmore's views are correct, the legitimacy of the doctrine is placed in serious doubt. However, the soundness of Professor Gilmore's argument has been questioned by a number of commentators in the United States (see, e.g., Skipworth, *supra*, note 119 at 228; G.S. Nelson & D.A. Whitman, *Cases and Materials on Real Estate Transfer, Finance, and Development*, 2d ed. (St. Paul's, Minn.: West Publishing, 1981) at 850).

Would Gilmore's argument be valid in Canada? Traditionally, the Anglo-Canadian position with respect to contracts to lend money has been not to specifically enforce them (see generally G.H.L. Fridman, *The Law of Contract in Canada*, 2d ed. (Toronto: Carswell, 1986) at 717; A.G. Guest, ed., *Chitty on Contracts*, vol. 1, 25th ed. (London: Sweet & Maxwell, 1983) at § 1768). More recently, however, there have been strong *dicta* by a number of courts suggesting that specific performance may be ordered where a mortgagee has a commitment to advance funds to a mortgagor but nevertheless refuses. See, e.g., *Frankel Structural Steel Ltd v. Goden Holdings Ltd* (1969), 5 D.L.R. (3d) 15 at 19 (Ont. C.A.), *aff'd in part* (1971), [1971] S.C.R. 250 (Laskin J.A. (as he then was) intimating that in an extraordinary set of circumstances specific performance might be ordered by a court); *Morguard Trust Co. v. 100 Main Street East Ltd* (16 March 1978) (Ont. Div. Ct.) [unreported] quoted at length in *Reid v. Garnet B. Hollowell Ltd* (1978), 10 R.P.R. 308 at 311-12 (M.C.) (O'Leary J. suggesting that a mortgagor could compel advancement or specific performance if a mortgagee, who has made a commitment to advance funds up to a certain amount, refuses to do so for capricious, arbitrary, and selfish reasons); *Two Hills Rental Properties Ltd and Bahnuik v. First City Trust Company* (1982), [1982] 2 W.W.R. 555 at 570 (Alta. Q.B.), leave to appeal dismissed (1983), [1983] 6 W.W.R. 1vi (Alta. C.A.). As well, Fridman has suggested (*ibid.* at 717) that based on the rationale of a majority of the Law Lords in *Beswick v. Beswick* (1967), [1968] A.C. 58 (H.L.), a court might order specific performance where an award of damages might be purely nominal and where the party in breach would be unjustly enriched. Moreover, in today's capital markets, it is likely that the rate of interest may change due to changes in monetary policy that are entirely unrelated to the borrower's credit standing. Under such conditions, damages, as even Gilmore acknowledges, would be recoverable. As a result, if an obligatory advance rule existed in Canada, it could be defended as being conceptually sound under Canadian contract law.

¹²⁴ See, e.g., *S & S Ceiling & Partition Co. v. Calvon Corporation* (1979), 410 N.E.2d 777 at 781 (Ohio C.A.) (promissory note and mortgage clearly contemplate the possibility of future advances being made and give the maximum amount to be lent, but the wording used in the documents does not create an obligation to disburse the funds; accordingly, the court held the advances to be optional).

and academics also say little in its defence.¹²⁵ The distinction is unworkable, unrealistic, and meaningless, and gives rise to irreconcilable decisions.¹²⁶

The problems with this doctrine arise because economic realities preclude such a simplistic approach of having arrangements solely optional or obligatory. Instead, well-drafted construction loan agreements contain provisions that list a number of events of default. Such provisions give lenders the option of discontinuing disbursements when a certain event occurs. It is generally recognized that these provisions represent good lending practice.¹²⁷ If lenders, however, are too diligent in protecting themselves, they might inadvertently transform what would have been obligatory advances into optional ones.

*National Bank of Washington v. Equity Investors*¹²⁸ illustrates this point well. In that case, a bank's duty to advance funds under a construction loan agreement was conditional upon the borrower providing the bank with a current appraisal, retention of an architect, and periodic progress reports of the project from the architect; all of these requirements were

¹²⁵ One virtue of this rule in Professor Gilmore's opinion is the wide area of discretion provided judges. As the learned Professor states, *supra*, note 11 at 930:

There are few, if any, future advance clauses which an astute judge cannot, at will, classify on one side or the other of the line between obligatory and voluntary. When he has picked his label, he has also picked his priority rule. The distinction amounts to an absence of rule; the judges are invited to pick and choose, case by case, ad hoc or ad hominem. This is a recurrent phenomenon in a common law system when arguments for or against a given position balance each other exactly. There is much to be said for allowing the mortgagor freedom to choose new sources of financing and for allowing new lenders to come in with secure liens. Only a very wise or a very foolish man would be willing to state categorically where truth lies and to propose a rule for application in all possible situations. There is, then, much to be said for having no rule at all, or only a make-believe rule, and for letting judges decide: judges are not necessarily wiser than other people, but they are paid to decide things.

But see Osborne, Nelson & Whitman, *supra*, note 119 at 762-63, who say that although Gilmore's argument is appealing, it is "ultimately unconvincing" because the cost of learning the answer in a given case (*i.e.*, lawyers' fees, court costs, and the time of witnesses) is far too high. The authors, therefore, conclude that "a rule which could be applied with certainty, whatever its content, would be preferable." To the same effect, see Nelson & Whitman, *supra*, note 123 at 851.

¹²⁶ Kratovil and Werner describe the obligatory-optional advance doctrine as "a legalistic test which is out of touch with reality." It also gives rise to excessive amounts of litigation, "yielding inconsistent and often surprising results in light of the language of the statutes": Kratovil & Werner, *supra*, note 119 at 314, 321. Another commentator has described the present system as being unpredictable and too often fortuitous: Osborne, Nelson & Whitman, *ibid.* at 763. Professor Gilmore has probably used the most figurative and vibrant language to show his disappointment with the present doctrine. In his seminal work (*supra*, note 11), Gilmore has said that "[t]he distinction, deeply rooted as it is, has little or nothing to recommend it conceptually; it may be helpful, by way of clearing away a little underbrush before moving into the forest. . . ." (at 926). As well, he later described the distinction between obligatory and optional advances as being essentially meaningless. It is, instead, merely "a way of avoiding a hard and fast rule in a situation where the equities seem to be in even balance" (at 938).

¹²⁷ *National Bank of Washington v. Equity Investors* (1973), 506 P.2d 20 at 28 (Wash. S.C.).

¹²⁸ *Ibid.*

to be "satisfactory" to the bank. In addition, funds were "to be advanced at such times and in such amounts as the Lender shall determine"; they were not due, moreover, unless the bank believed that all the work for which the advance had been made was done in a good and workmanlike manner. The construction loan agreement also provided that the bank was not obligated to disburse more than 90 percent of the loan until the construction was completed and the property free of all kinds of liens except the bank's. The Washington Supreme Court concluded that, because the bank's discretionary powers under the contract were so broad and covered so many possible situations, the bank, in effect, had no definite obligation to advance any funds. As the Court said: "The lender, in reserving such broad protective discretion, thereby rendered the advances optional rather than obligatory for the purpose of determining the priority of liens."¹²⁹

The inadequacies and uncertainties of the obligatory-optional advance rule become even more apparent where lenders have not reserved excessive discretion and have kept 'events of default' clauses to a minimum. When such clauses are relatively unsophisticated and thus easy to fulfill, the courts have been generally willing to hold any advances that follow as obligatory.¹³⁰ But where borrowers fail to perform or meet a condition of the loan agreement or lenders fail to assert all of the conditions (even those conditions that are far more restrictive than are required in the circumstances), a majority of the courts have held that such an event causes the advances to become voluntary.¹³¹

¹²⁹ *Ibid.* at 29. It has been held that future advances made under a mortgage agreement will not be obligatory unless the mortgage and the other documents bind the lender to disburse a certain amount of money under definite conditions or in a particular manner: *Wayne Building & Loan Co. of Wooster v. Yarrowborough* (1967), 228 N.E.2d 841 at 858 (Ohio S.C.); *Akron Savings & Loan Co. v. Ronson Homes, Inc.* (1968), 238 N.E.2d 760 at 763 (Ohio S.C.).

¹³⁰ See, e.g., *Irwin Concrete, Inc. v. Sun Coast Properties, Inc.* (1982), 653 P.2d at 1336-37 (Wash. C.A.) (under the deed of trust, lender obligated to disburse funds requested by builder once the lender was able to verify that the cost of the work done by the builder equalled the amount requested); *Ashdown Hardware Co. v. Hughes* (1954), 267 S.W.2d 294 (Ark. S.C.) (under the terms of the mortgage, mortgagee obligated to make advances as each cabin to be built by the owner is completed and insured); *Local Federal Savings & Loan Ass'n v. Davidson & Case Lumber* (1952), 255 P.2d 248 (Okla. S.C.) where the mortgagee was bound by the terms of a mortgage to advance funds at various states of construction. The clause, which required the owner to give proper evidence that all materials and labour have been paid at the time of each disbursement of funds, was construed by the Court as not giving the mortgagee the right to withhold the proceeds of the loan or to pay it out as the mortgagee desired. See also the cases listed in 80 A.L.R.2d 179 at 198-99.

¹³¹ See, e.g., *Housing and Mortgage Corp. v. Allied Const. Inc.* (1953), 97 A.2d 802 at 806 (Penn. S.C.) (progress payments made ahead of schedule held to be optional); *J.I. Kislak Mortgage Corporation v. William Matthews Builder, Inc.* (1972), 287 A.2d 686 (Del. S.C.), *aff'd* (1973), 303 A.2d 648 (Del. C.A.) (construction loan agreement provided that the lender would not be obligated to make advances unless the mortgagor provided the lender with documentation showing that prior advancements had been used to pay subcontractors and material suppliers; notwithstanding the language, the lender made advances without requiring receipts; held by the court that the advances were optional and subordinate to the filed mechanics' liens).

Furthermore, sound lending practices would suggest that a lender retain the right to complete construction if the borrower should abandon or take too long in completing the project. However, several courts have held that advances used to complete the building are optional and are thus subordinate to a mechanic's liens.¹³² One commentator has suggested that such cases vividly demonstrate the inadequacy of this doctrine: "It fails at the very moment it is needed. If the job gets into trouble, the *event of default* clause operates in many states to render advances made thereafter optional."¹³³

Therefore, the obligatory-optional doctrine, as currently enunciated by American courts, is badly flawed. Lenders who attempt to create obligatory advances, yet provide themselves with some protection, can never be totally certain that a court will subsequently hold the advances to be obligatory.¹³⁴ The most one can say, after reviewing the American case law, is that there are few, if any, future advance clauses that a judge cannot reasonably classify as optional.¹³⁵ As a result, if "contracted for" is, as suggested above, limited to only obligatory advances, the scope of protection provided to construction mortgagees has not been expanded

There are, however, some cases that have held that a failure to fulfill a condition of a loan agreement does not necessarily destroy the obligatory nature of the advance. See, e.g., *Hyman v. Hauff* (1893), 33 N.E. 735 at 737 (N.Y.C.A.) and *Landers-Morrison-Christenson Co. v. Ambassador Holding Co.* (1927), 214 N.W. 503 at 506 (Minn. S.C.), which held that the undertaking of lenders to make future advances is not deemed optional within the rule that gives subsequent encumbrances priority over optional advances made after they have been recorded unless it appears from the lenders' agreement that they have a right to decline to make them. However, where the right to refuse to make the advances depends upon a breach of the agreement by the borrower, lenders are not required to take the chance of establishing such a breach to the satisfaction of a court but rather may disregard the breach and make the stipulated advances in reliance on their security. See also *Weissman v. Volino* (1911), 80 A. 81 at 82 (Conn. S.C.). One commentator has suggested that it is possible to understand these three cases as a recognition by the courts of the "economic dilemma" facing lenders under the obligatory-optional advance doctrine: Skipworth, *supra*, note 119 at 225 n. 5.

¹³² See, e.g., *Yost-Linn Lumber Co. v. Williams* (1932), 9 P.2d 324 (Cal. Dist. Ct.), where the mortgage agreement provided that if construction was abandoned prior to completion the mortgagee could, after thirty days, at its option, complete the building using the unexpended funds remaining in its hands. The court held that the funds expended by the mortgagee after the builder's default were voluntary and subordinate to the mechanic's liens.

¹³³ Kratovil & Werner, *supra*, note 119 at 315 (emphasis in original).

¹³⁴ One possible drafting approach is to provide in the mortgage or the construction loan agreement that no default shall occur despite the occurrence of any of the default conditions until the lender gives the borrower written notice of default. Another approach is to provide, *inter alia*, that

[f]unds advanced by the lender in the reasonable exercise of his judgment that the same are needed to complete the improvement or to protect his security are to be deemed obligatory advances hereunder and are to be added to the total indebtedness secured by the note and mortgage and said indebtedness shall be increased accordingly.

The success of either of these techniques is, however, uncertain: see Skipworth, *supra*, note 119 at 226-27.

¹³⁵ *Accord* Osborne, Nelson & Whitman, *supra*, note 119 at 763; Skipworth, *ibid.* at 227. See also Professor Gilmore's observation quoted in note 125, *supra*.

much from the protection previously provided by the words 'made before real estate notification'.¹³⁶

b) *The Canadian common-law position*

An even more serious obstacle against construing the phrase "contracted for" to mean obligatory advances is the Canadian common law itself. In contrast to the American position, Canadian courts have consistently held that advances made by a mortgagee under a contractual obligation are not entitled to priority after the mortgagee receives actual notice of an intervening security interest or encumbrance.¹³⁷ The courts have, however, carved out a narrow exception by distinguishing between advances voluntarily made after notice of an intervening encumbrance and advances involuntarily made upon a liability to a third party already in existence at the time the intervening encumbrance was created.¹³⁸

Therefore, there would have had to be a change in Canadian real estate law before the American position could be adopted. Yet, nowhere in the Catzman Committee's commentary on the PPSA is there a suggestion

¹³⁶ The deficiencies of the doctrine have caused a number of states to modify it by legislation giving all future advances the same priority as the original advance irrespective of their optional character. For a discussion of the changes made in the individual states, see Osborne, Nelson & Whitman, *ibid.* at 768-71. A similar approach has also been taken by the drafters of the 1972 Code in respect of personal property. Article 9-105(1)(k) now provides: "An advance is made 'pursuant to commitment' if the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation."

¹³⁷ See, e.g., *West v. Williams* (1899), 1 Ch. 132 (C.A.) at 143-44, where Lindley M.R. stated that the giving of a subsequent encumbrance by the mortgagor on the security extinguished the contractual obligation of the prior encumbrancer to make future advances. See also *I.W.A. Credit Union v. Johnson* (1978), 6 B.C.L.R. 271 (S.C.). See generally Rayner & McLaren, *supra*, note 23 at 163-64. In England, *West v. Williams* seems to have been overruled by statute. See *Law of Property Act, 1925*, 15 & 16 Geo. 5, c. 20, s. 94(1)(c). See generally E.L.G. Tyler, ed., *Fisher and Lightwood's Law of Mortgage*, 9th ed. (London: Butterworths, 1977) at 459-62. But see D.B. Kirkham, "Priorities of Mortgages — Mortgage for Present and Future Advances — Whether First Mortgagee May Tack Future Advances where there Has Been an Intervening Encumbrance" (1968) 6 Alta. L. Rev. 310 at 312, where the author suggests that there is a certain amount of ambiguity in the provision and that given the English Court of Appeal's reasoning in *West v. Williams* the statute may not be applicable.

¹³⁸ See, e.g., *Royal Bank of Canada v. Doering* (1923), [1924] 1 D.L.R. 488 (B.C.S.C.) (first mortgagee guaranteed a promissory note of the mortgagor); *Kingsway Electric Co., Ltd v. 330604 Ontario Ltd* (1979), 27 O.R. (2d) 541 (H.C.) (first mortgagee gave an irrevocable commercial letter of credit to a bonding company on the account of a contractor).

Cf. Michael v. Bank of Montreal (1982), 141 D.L.R. (3d) 169 at 172 (P.E.I.S.C.), where Campbell J. stated that:

the doctrine of tacking as it applies in Prince Edward Island is as follows: advances made pursuant to a first mortgage but after a second mortgage is given, may be tacked on to the prior security if the advances are made (a) without actual notice of the subsequent mortgage, or (b) pursuant to a contractual obligation to advance the funds.

After holding that it had not been clearly demonstrated that the bank was irrevocably committed to making the subsequent advances, he added (at 172) that "it is a fine point at common law at which the bank must be shown to have been irrevocably obligated to supply further funds."

that it contemplated changing Canadian real estate law. Indeed, given that the statute under the Committee's consideration deals almost exclusively with personal property,¹³⁹ it would be reasonable to assume that well-established doctrines in real estate law are to remain in effect unless expressly reversed.¹⁴⁰ Moreover, the mere fact that the law pertaining to future advances in regards to personal property appears to have been altered¹⁴¹ is not sufficient to rebut the presumption that real estate law has not been modified by the Committee.¹⁴²

How then is the phrase "contracted for" going to be interpreted in Canada? Professor McLaren suggests that no advance could be deemed "contracted for" until the mortgagee is satisfied that there are no intervening encumbrances.¹⁴³ It would also be consistent with our common-law position to construe "contracted for" to include the infrequent case of the mortgagee who, even after learning of the fixture interest, is nevertheless compelled to honour the commitment. Construing "contracted for" in this fashion means that the phrase would, in practical

¹³⁹ See note 5, *supra*, and accompanying text.

¹⁴⁰ See generally E.A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983) at 107, 149-61; Lord Hailsham of St. Marylebone, ed., *Halsbury's Laws of England*, vol. 44, 4th ed. (London: Butterworths, 1983) at § 904.

¹⁴¹ Most commentators believe that the Catzman Committee intended to change the common-law rule in respect of future advances by providing that once a security interest has been perfected, all future advances would be secured by a continuously perfected security interest in the collateral. It is possible, however, to argue that each advance in a transaction contemplating future advances creates a separate and distinct security interest. If the separate security interest approach rather than the continuous security interest approach is followed by the courts, then the common-law rule will not have been overturned. For a discussion of these two approaches, see McLaren I, *supra*, note 8 at §§ 2.02[3], 6.01[2][c]; Catzman *et al.*, *supra*, note 1 at 77-82. The debate as to the preference of these two approaches can also be found in the United States. Compare Gilmore, *supra*, note 11 at 933-42 (continuous security interest), and P.F. Coogan & N. Gordon, "The Effect of the Uniform Commercial Code upon Receivables — Some Answers and Some Unresolved Problems" (1962-63) 76 Harv. L. Rev. 1529 at 1549-51 (separate security interest).

In order to expressly reject the common-law rule with respect to future advances, the drafters of the 1985 *Draft Act*, *supra*, note 15, have defined the term "future advance" to mean "the advance of money, credit, or other value secured by a security agreement whether or not such an advance is given pursuant to commitment" (at 3). Even more important, the drafters added two new priority rules to deal expressly with the problem of future advances. Section 33(3) of the 1985 *Draft Act* gives all future advances the same priority as the initial advance (at 47), thereby codifying the continuous security interest approach. An exception to the above priority rule is s. 33(4). That subsection provides that an execution creditor's right will not be subordinate to any advances made after the secured party received written notification of the execution's existence unless the secured party is contractually bound to make the advance, "whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from the obligation" (at 47).

¹⁴² Accord J.S. Ziegel, "Interaction of Personal Property Security Legislation and Security Interests Under the Bank Act" (1986) 12 Can. Bus. L.J. 73 at 83 n. 36, where it is possible to infer from his remarks that he believes the *PPSA* has, at the very most, only changed the law of future advances involving personal property. See generally Driedger, *supra*, note 140 at 211-14.

¹⁴³ McLaren II, *supra*, note 8 at 258.

terms, have only a negligible impact on the underlying policy of section 36.¹⁴⁴

c) *The timing of the commitment*

One final problem arising from the words "contracted for" concerns the timing of the contract or commitment. Under the common law, any commitment made before the conflicting security interest is known would be protected.¹⁴⁵ Section 36(3)(c) is, however, designed to protect only prior encumbrancers who enter into commitments or make advances in reliance of value already existing on the real estate. Therefore, a commitment that is made before the chattel security interest attaches or after attachment of the security interest but before affixation of the fixture will not be in any sense "subsequent" within the meaning of section 36(3)(c),¹⁴⁶ *unless* the mortgagee actually makes the advance after the goods have become fixtures but before real estate notification.¹⁴⁷

Thus, in most instances, construction mortgagees should only be protected by section 36(3) if they make their commitment to advance *or* make their advance: (1) after the security interest has attached; (2) after the annexation of the fixture; and (3) before real estate notification.¹⁴⁸ The only exception would be in those rare instances where the mortgagee is compelled to make an involuntary advance.

C. *The Need for Change*

Some American commentators have argued that by construing the present section as suggested above, the *1962 Code* (and by extension

¹⁴⁴ See note 148, *infra* and accompanying text.

¹⁴⁵ See notes 116 & 137, *supra*.

¹⁴⁶ See text accompanying notes 104 & 105, *supra*. See also Kripke, *supra*, note 11 at 72, where the author states that while it is true that "all construction commitments are in a sense made in expectation of a subsequent increase in the value of the real estate . . . they are not made in *reliance* thereon because the commitment is never binding until the lender is satisfied that the value has been added free of lien." (emphasis in original) *Accord McLaren II, supra*, note 8 at 258.

¹⁴⁷ It would be inequitable to penalize a construction mortgagee for making a prior commitment if the advance was actually made after the goods had become fixtures because, presumably, the lender had waited until the goods were affixed to the realty in order to search the real estate records for notice of a security interest. Finding no information, the mortgagee incorrectly assumed that value had been added free of any other encumbrances. Thus, the *prima facie* preference given to a fixture financier is lost by the financier's inaction.

¹⁴⁸ Kripke, *supra*, note 11 at 73. But see McLaren II, *supra*, note 8 at 258, where the author states that both the commitment to advance *and* the advance itself must be made after the goods have become fixtures. Such a rule not only unfairly penalizes the construction mortgagee, but also fails to take into account all the possibilities that can arise in construction mortgage financing. In a telephone conversation on March 6, 1986, Professor McLaren agreed with the foregoing but noted that his position reflected the general practice of construction mortgagees who do not commit their money until they have received proof that the work has been completed.

the *PPSA*) gives construction mortgagees little protection against purchase money security interests in fixtures that have been installed on the mortgaged land during the course of construction.¹⁴⁹ Therefore, to protect themselves, construction mortgagees would have to search the land registry office before making each advance. The American Real Estate Bar believed that this added duty was unfair. In response to its outcry, changes were proposed to the fixture section. As a result, the fixture section in the *1972 Code* reverses the *1962 Code*'s position by adopting a special priority rule favouring construction mortgagees whenever they are in conflict with holders of fixture security interests.¹⁵⁰

A similar provision is unlikely to be adopted in Ontario for a number of reasons. First, if the American approach were adopted, the province's long-standing policy favouring sellers of fixtures would come to an end. Such a change would force fixture vendors to change drastically the way they secure their sales. For instance, they would have to enter into subordination agreements with holders of conflicting real estate interests in order to gain priority. If this was not possible, they would be unable to rely on the goods sold as security, as they customarily do now. Instead, they would have to look for other collateral to secure the sale or refuse to sell to contractors when they believed a construction mortgage was involved. The end result would be an increase in the costs and risks of doing business for fixture suppliers.

Second, in contrast to the situation in the United States, no additional burden is created in Ontario by requiring construction mortgagees to search the land registry office before making each advance in order to protect their advance against an intervening fixture security interest. Prudent construction mortgagees already search the registry office before

¹⁴⁹ In fact, the vulnerability of construction mortgagees was considered to be the "weightiest objection" to § 9-313 of the *1962 Code*: Adams, *supra*, note 7 at 908.

¹⁵⁰ *1972 Code*, § 9-313(6). More specifically, if at the time the fixture is installed a construction mortgage has already been recorded, then the mortgagee will have priority over the financier of the newly installed goods that are part of the original construction. The provision makes no distinction between optional and obligatory advances. Moreover, it appears from comparing the *1972* and *1962 Codes* that the construction mortgage will prevail over an intervening security interest in fixtures whether or not the mortgagee has knowledge of the security interest when an optional advance is made. Nevertheless, the construction priority does not apply to additions made to a building after completion of the improvement. Nor does the priority of § 9-313(6) extend to a fixture security interest perfected through a fixture filing prior to the recording of the construction mortgage (§ 9-313(4)(b)). For a more detailed discussion of this section, see Coogan 1, *supra*, note 8 at § 3A.02[6]; Adams, *ibid.* at 908-9. *Cf.* Gilmore's more moderate reform proposal of requiring fixture-secured parties with an interest in articles over some fixed dollar figure to give actual notification of their security interests to record owners and mortgagees: Gilmore, *supra*, note 11 at 834-36.

making each advance because under the *Construction Lien Act*,¹⁵¹ formerly the *Mechanics' Lien Act*,¹⁵² a lien has priority over all advances made on account of a mortgage after notice in writing of the lien has been given to the mortgagee making the payments or after registration of the claim for the lien.

Third, even if they do not search the registry office before each advance, on balance construction mortgagees are in a better position than holders of the fixture security interests to guard against double financing by controlling the disbursement of mortgage funds. They can, for example, require an architect's certificate of completion before making payments at any stage, retain a certain percentage of the loan until all work is satisfactorily completed, and so on. Such measures ensure that the construction mortgagee is not left with insufficient security to cover the loan.

There is, therefore, no convincing reason why Ontario should adopt the approach taken in the *1972 Code*. Section 36, if construed as suggested above, gives each party a satisfactory means of self-protection. Although only dimly seen through the section's hazy language, the crucial policy question focuses on who has the better reliance interest as between the construction mortgagee and the fixture seller or financier. The section needs clarification to eliminate its current uncertainties, but its underlying policy should be retained.¹⁵³

V. TENANTS' FIXTURES: APPLICABILITY OF SECTION 36 AND REAL ESTATE NOTIFICATION

There are two principal situations in which goods are sold subject to a security interest to a debtor who does not own the land to which the goods become affixed. The first case involves fixtures installed by a tenant; the second, fixtures installed by a contractor working on someone else's land. Neither of these situations is satisfactorily dealt with by the *PPSA*.

Turning first to the tenants' case, suppose a tenant purchases an air-conditioning unit, subject to a seller's security interest, and installs it in a place of business that is being leased. Assume further that the

¹⁵¹ *Supra*, note 27, ss 80(4), (6). See generally D.N. Macklem & D.I. Bristow, *Construction and Mechanics' Liens In Canada*, 5th ed. (Toronto: Carswell, 1985) at § 63.

¹⁵² R.S.O. 1980, c. 261, s. 15(1).

¹⁵³ See Gilmore, *supra*, note 11 at 832, where he explains why words like "contracted for" should be eliminated from the *1962 Code*: "An astute and sensitive court might manipulate 'contracted for' in such a way as to do only good, while avoiding evil. The prospect of such a delicate balancing of equities is not, however, one that many lawyers will look forward to with unalloyed pleasure."

landlord then gives a real estate mortgage and the conditional seller subsequently wants to remove the air conditioner because the tenant has gone into default. If the seller of the fixture never makes a real estate filing under section 54(1)(a), can the conditional seller rely upon the tenant's right to remove the air conditioner? Or is the seller's security interest subordinated to the subsequent mortgagee's interest by virtue of section 36(3)(a)? These questions cannot be answered with certainty because the *Act* is not clear on whether 'fixtures' in the *PPSA*'s sense of the term includes tenants' or trade fixtures.

The uncertainty stems from the fact that courts have traditionally treated tenants' fixtures very differently from other fixtures.¹⁵⁴ While fixtures were generally viewed as having the legal characteristics of real estate and not being removable, an exception was carved out for tenants' fixtures.¹⁵⁵ Not only could tenants' fixtures be removed, but also they had characteristics of both personal and real property. When viewed as separate and removable property of the tenant, these fixtures would be classified as chattels,¹⁵⁶ but when considered in connection with the freehold, the same goods would become realty.¹⁵⁷ Because tenants' fixtures are the only ones to have this dual character, it is possible to argue that they do not come within the scope of section 36 of the *PPSA*.

If section 36 has no application to tenants' fixtures, a court must look at the landlord and tenant relationship to determine the fixture seller's rights, since they will depend on the tenant's rights. Under the common law, a tenant may, in the absence of an agreement to the contrary, remove

¹⁵⁴ *Poole's Case* (1703), 1 Salk. 368, 91 E.R. 320 is the leading case and one of the earliest recorded inroads upon the basic principle. For even earlier cases, dating as far back as 1505, see Niles, *supra*, note 39 at 565 n. 38.

¹⁵⁵ Dean Niles has stated that "the maxim [*quicquid plantatur solo, solo cedit*] furnishes the common denominator of all fixture cases — the general principle to which the rules as to trade or ornamental fixtures are somewhat anomalous exceptions." Niles, *ibid.* at 561.

¹⁵⁶ For example, when tenant's fixtures are being sold by a tenant, the transaction does not have to be in writing or satisfy the requirements of the *Statute of Frauds*: *Lee v. Gaskell* (1876), 1 Q.B.D. 700; *Hallen v. Runder* (1834), 1 C.M. & R. 266, 149 E.R. 1080; *Petrie v. Dawson* (1845), 2 C. & K. 138, 175 E.R. 58; *Oswald v. Whitman* (1889), 22 N.S.R. 13 (C.A.); *Argles v. McMath*, *supra*, note 39 at 226; *Liscombe Falls Gold Mining Co. v. Bishop*, *supra*, note 51. The mortgages that tenants give on their fixtures are called *chattel mortgages*: *London & Westminster Loan and Discount Co. Ltd v. Drake* (1859), 6 C.B. (N.S.) 798, 141 E.R. 664. Moreover, judgment creditors may seize tenant's fixtures under a writ of *fiat facias*, which would not be possible if the fixtures were realty: see cases cited in note 164, *infra*.

¹⁵⁷ Tenants' fixtures are considered, for instance, as part of the real estate under the *Assessment Act*, R.S.O. 1980, c. 31, s. 1(k)(iv). See also *Richmond and Richmond v. Ashton* (1961), 31 D.L.R. (2d) 12 (Ont. H.C.); *Northern Broadcasting Company, Ltd v. The Improvement District of Mountjoy* (1950), [1950] S.C.R. 502. Landlords do not have a right to distrain tenants' fixtures for arrears in rent as they could their loose chattels: *Hellawell v. Eastwood* (1851), 6 Ex. 295, 155 E.R. 554. See also Oosterhoff & Rayner, *supra*, note 23 at 1055 n. 4 and cases cited therein.

personal chattels that have become affixed to the leased premises for the purposes of carrying on a trade, so long as the removal can be effected without serious injury to the freehold.¹⁵⁸ Accordingly, a court would hold that the air conditioner in the above example was a trade fixture that could be removed by the tenant, assuming that the removal would not cause substantial damage.¹⁵⁹ A tenant's right of removal would also be enforceable against a subsequent mortgagee of the freehold¹⁶⁰ so long as the tenant was in possession of the land at the time the mortgage was given by the owner or landlord because the tenant's occupation is constructive notice to the subsequent mortgagee of the tenant's rights.¹⁶¹

Moreover, other parties can also benefit from a tenant's right of removal because such rights are "of the nature and quality of property rights as opposed to personal licences or contract rights."¹⁶² Accordingly, tenants have the power to transfer either a present or reversionary interest in their fixtures to a stranger, to a succeeding tenant, or to the landlord.¹⁶³ As well, these fixtures are liable to be taken by parties who have no interest in the land to which the chattel is affixed but who claim to

¹⁵⁸ See notes 48 to 51, *supra* and accompanying text.

¹⁵⁹ See, e.g., *Security Alert Systems Ltd v. Hart Leasing & Holding Ltd* (1983), 39 Nfld. & P.E.I.R. 340 (Nfld. Dist. Ct.) (air conditioner was a trade fixture that could be removed by the tenant).

¹⁶⁰ This is not the case if a tenant mortgages the leasehold. In such instances the harsh and inflexible rules that are applicable as between vendor and purchaser, or mortgagor and mortgagee of the freehold apply with equal force as between a tenant-mortgagor and mortgagee. See, e.g., *Meux v. Jacobs* (1875), L.R. 7 H.L. 481 at 491; *Warner v. Don and Rogers* (1896), 26 S.C.R. 388 at 394. See also Manning, *supra*, note 23 at 309 where he states that

although the [tenant]-mortgagor may have the right as against his landlord to set up the fact that the articles in dispute are trade fixtures, he has no such right as against his mortgagee, for the law respecting trade fixtures does not apply to enable the mortgagor to remove things which, as between landlord and tenant, are trade fixtures any more than does the law between vendor and purchaser. *One must always be careful to distinguish between the cases as between landlord and tenant and the tenant and his mortgagee.* [Emphasis added.]

¹⁶¹ *Stack v. T. Eaton Co.*, *supra*, note 59 at 338; *Thistlethwaite v. Sharp* (1912), 7 D.L.R. 801 (Sask. Dist. Ct.); *Scott Fruit Co., Ltd v. Wilkins and Reece* (1920), 54 D.L.R. 401 (Alta. S.C.); *Cronkhite v. Imperial Bank of Canada* (1906), 14 O.L.R. 270 (Div. Ct.); *Scarth v. Ontario Power and Flat Co.*, *supra*, note 96. This principle also applies where the parties have determined their respective rights as to the ownership and removability of fixtures in a written (*Thistlethwaite v. Sharp*, *ibid.*) or under a verbal (*Butterworth v. Ketchum* (1904), 3 O.W.R. 844 (C.A.); *Close v. Belmont* (1875), 22 Gr. 317) agreement. However, any rights that tenants are able to bargain for over and above that which they are entitled to at common law will be lost if the requirements demanded by the various recording Acts are not satisfied. See generally Campbell, *supra*, note 23 at 50-51.

¹⁶² Niles, *supra*, note 39 at 573. See also *Argles v. McMath*, *supra*, note 39 at 236.

¹⁶³ *Devine v. Callery*, *supra*, note 59 at 510, Riddell J.; *Oswald v. Whitman* (1889), 22 N.S.R. 13 (C.A.); *Wintemute v. Taylor* (1919), [1919] 2 W.W.R. 882 (B.C.S.C.); *Gillett v. Lawrence Ltd* (1922), [1922] 2 W.W.R. 584 (Sask. C.A.). See also Niles, *ibid.* at 571 and cases cited therein.

have an interest in the article itself, such as a judgment creditor,¹⁶⁴ a chattel mortgagee,¹⁶⁵ or a conditional seller.¹⁶⁶ If a tenant can remove trade fixtures even against a subsequent purchaser or mortgagee of the freehold, it intuitively follows that these same real estate interests should not be able to stop a chattel encumbrancer from repossessing and removing the tenant's trade fixtures.¹⁶⁷ There is then no justification for deliberately requiring a financier of tenants' fixtures to file a notice in the proper registry office because the real estate notification would serve no purpose.

There is, however, some difficulty with this position. Some court decisions have referred to tenants' fixtures as retaining their "character of chattels"¹⁶⁸ and thus not as part of the real estate. The generally accepted Anglo-Canadian position, however, is that such fixtures have become part of the realty and therefore can be included in an owner's real estate conveyance subject to the tenant's right to sever and reconvert them back into personal property.¹⁶⁹ Given this view, one would expect that as long as the goods remained affixed to the land, the priority and removability rules of section 36 would apply to resolve all conflicts arising

¹⁶⁴ See, e.g., *Poole's Case*, *supra*, note 154 at 320, where Lord Holt held that because tenants have "a power coupled with an interest" in their removable fixtures, a judgment creditor has the right to seize a tenant's trade fixtures under a writ of *fiery facias*. In other words, even though the fixtures have apparently become part of the realty and therefore are the property of the freeholder, a judgment creditor can, nevertheless, dis-connect the fixtures, re-acquire full ownership in them, and re-establish them as chattels. See also *Minshall v. Lloyd* (1837), 2 M. & W. 450 at 459, 150 E.R. 834 at 839 (an execution creditor has "the same right of removal as the tenant"); *Winn v. Ingilby Bart. and Hauxwall* (1822), 5 B. & Ald. 625, 106 E.R. 1319; *Evans v. Roberts* (1826), 5 B. & C. 829 at 841, 108 E.R. 309 at 313; *Argles v. McMath*, *supra*, note 39 at 236.

¹⁶⁵ *London & Westminster Loan and Discount Co., Ltd v. Drake*, *supra*, note 156 at 669 (E.R.).

¹⁶⁶ *Joseph Hall*, *supra*, note 46 at 470, where Chief Justice Cameron stated that "[t]he position of the owner of the goods which the tenant has affixed to the demised premises cannot be less strong than that of the tenant's assignee." See also *British Economical Lamp Company v. Empire Mile End, Ltd* (1913), 29 T.L.R. 386 at 387 (K.B.), Lawrence J. But cf. *Cormier*, *supra*, note 8 at 168, where Salhany Co. Ct. J. said, without referring to any of the above cases, that a chattel mortgagee or conditional vendor can only have the benefit of the tenant's rights of removal when some agreement in writing or otherwise exists that transfers the debtor-tenant's interest to the creditor and this agreement must be something more than simply the debtor-tenant having gone into default on the security agreement.

¹⁶⁷ *Accord Ziegel*, *supra*, note 46 at 516. In the United States, this right is well-established. See, e.g., A. Casner, ed., 5 *American Law of Property* (Boston: Little, Brown, 1952) § 19.12 at 48 n. 5. See also the cases collected in (1926), 45 A.L.R. 967 and (1935), 98 A.L.R. 628.

¹⁶⁸ See, e.g., *Blanshard v. Bishop* (1911), 2 O.W.N. 996 (H.C.) (distress justifiable since a tenant's trade fixture is a chattel); *Simons v. Mulhall* (1913), 24 O.W.R. 736 at 738 (H.C.) (trade fixtures spoken of as chattels). See generally *Oosterhoff & Rayner*, *supra*, note 23 at 1009-10; *Manning*, *supra*, note 23 at 293-94.

¹⁶⁹ *Stack v. T. Eaton Co.*, *supra*, note 59 at 338, where Meredith C.J. held, *inter alia*, as settled law:

That, even in the case of tenants' fixtures put in for the purposes of trade, they form part of the freehold, with the right, however, to the tenant, as between him and his landlord, to bring them back to the state of chattels again by severing them from the soil, and that they pass by a conveyance of the land as part of it, subject to this right of the tenant.

See also *Bain v. Brand*, *supra*, note 39 at 770, Lord Cairns L.C.; 772, Lord Chelmsford.

between realty and personalty interests in the trade fixtures. Indeed, the only reported Canadian case on this issue has held that tenants' fixtures are subject to section 36;¹⁷⁰ such a view is also supported by most commentators.¹⁷¹

Yet, there are some difficulties with this view as well. If tenants' affixations are fixtures for PPSA purposes, then the *Act* changes landlord and tenant law in at least two ways. First, in the example set out above, a land mortgage is taken after a tenant has purchased and installed an air conditioner subject to a chattel security interest of which the mortgagee has no actual knowledge. Under the common law, the tenant is given a right (good against a subsequent mortgagee) to remove the trade fixture because the tenant's possession of the premises is sufficient warning to a subsequent realty interest of the tenant's rights.¹⁷² Since these realty interest parties have notice that the tenant may remove the trade fixtures, it follows that other parties, such as one with a chattel security interest granted by the tenant, should be able to derive their priority from the tenant's right of removal.¹⁷³ Section 36(3) is, however, not drafted to yield this result. Under that provision, security interests in fixtures "are subordinate to the interest of . . . a subsequent purchaser or mortgagee for value of an interest in the real property . . . if the subsequent purchase or mortgage was made . . . without *actual* notice of the security interest."¹⁷⁴ [emphasis added] Accordingly, mere notice of the tenant's rights arising from the tenancy will no longer be sufficient to give the fixture financier priority over a subsequent mortgagee.

A second problem arises when the tenant has no right to remove the fixture under the lease or under the landlord and tenant law of the jurisdiction in question,¹⁷⁵ but the fixture seller has filed a notice of the security interest in the proper land registry office. The language used in subsections 36(1), (3), and (4) would seem to give fixture financiers the right to remove the fixtures irrespective of the rights or reliance

¹⁷⁰ See *Cormier*, *supra*, note 8 at 170.

¹⁷¹ McLaren I, *supra*, note 8 at § 6.03[1][b][i]; McLaren II, *supra*, note 8 at 250; White & Summers, *supra*, note 25 at 933; Adams, *supra*, note 7 at 863. Cf. Gordon, *supra*, note 12 at 669, where Professor Gordon argues that "the UCC's seeming obliviousness to the common law and the incongruity of its results give rise to a suspicion that the UCC does not deal with . . . [tenants' fixtures] at all."

¹⁷² See notes 158 to 161, *supra* and accompanying text.

¹⁷³ See notes 162 to 167, *supra* and accompanying text.

¹⁷⁴ Section 36(3)(a).

¹⁷⁵ For example, tenants lose the right to remove their fixtures where they have mortgaged their leasehold (see note 160, *supra*) or where they have abandoned their premises prior to the end of the term (see, e.g., *Veterans Manufacturing and Supply Co. v. Harris*, *supra*, note 49; *Nellis v. McNee* (1906), 7 O.W.R. 158 (Weekly Ct.)) or where removal will cause substantial damage to the freehold (see note 51, *supra*).

interests landlords and those claiming under them might have as against their tenants. Although the need to provide fixture financiers with protection is recognized, their right to prevail becomes more tenuous when a landlord is able to show that the tenant received a reduction in rent because the fixtures had been installed or that the landlord had acquired a substantial reliance interest in some other way. Furthermore, if one accepts the view that compliance with section 36 gives a chattel encumbrancer a right of removal irrespective of the tenant's rights, then one is implicitly saying that the chattel encumbrancer can, by properly filing, obtain greater rights to remove the fixtures than the tenant would have against the landlord or the mortgagee.¹⁷⁶ Yet under landlord and tenant law, a tenant's chattel encumbrancer usually has no greater rights than the tenant, except for a short opportunity to remove the fixtures if the tenant loses the right of removal by voluntarily surrendering the premises prior to the end of the lease.¹⁷⁷

Were such changes in the substantive law of landlord and tenant intended by the drafters? It is very doubtful. Rather, the drafters simply did not consider the application of section 36 to cases involving tenants' fixtures.¹⁷⁸ Additionally, real estate interests would probably not have acquiesced so easily if the change in the law of landlord and tenant, as illustrated in the second problem, had been more widely known to them. Such a significant change should not be made without a thorough airing of the problem.

If the present section introduces too much uncertainty as to the application of section 36 to tenants' fixtures or makes too many undesirable changes with respect to landlord and tenant law, then some alterations to the section will be required. One possible solution would

¹⁷⁶ Professor McLaren has suggested that a fixture financier may have greater rights against a real estate interest than does a tenant under landlord and tenant law because the secured party's rights are statutorily based while the tenant's rights arise only out of the common law (see McLaren II, *supra*, note 8 at 249). This argument, however, would only be persuasive if one could show that the Legislature (or, more accurately, the drafters) contemplated such a change. In reality, no such change was even considered. See note 178, *infra* and accompanying text. Surprisingly, there are no cases that consider this issue under the *Conditional Sales Act*. One commentator, however, asserts that a general reading of all the cases indicates that a conditional seller's right of removal will continue even if the tenant's right to remove fixtures does not exist: Campbell, *supra*, note 23 at 60.

¹⁷⁷ See *London & Westminster Loan and Discount Co., Ltd v. Drake*, *supra*, note 156; *Joseph Hall*, *supra*, note 46; *Saint v. Pilley* (1875), L.R. 10 Exch. 137 at 139.

¹⁷⁸ The drafters of the 1962 Code have said that they do not recall this problem being discussed: Gilmore, *supra*, note 11 at 833. Given that the PPSA is based substantially upon the 1962 Code and that neither the Catzman Committee (in Catzman *et al.*, *supra*, note 1) nor McLaren, a member of the Committee (in McLaren I, *supra*, note 8), give any indication of having considered this problem, it seems safe to assume that it was not discussed by the Ontario drafters.

be to adopt the approach taken in the 1972 Code. Section 9-313(5)(b), which deals with both of these problems, provides:

A security interest in fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate where . . . the debtor has a right to remove the goods as against the encumbrancer or owner. If the debtor's right terminates the priority of the security interest continues for a reasonable time.¹⁷⁹

Regarding the first problem, the section has been drafted specifically to deal with tenants' fixtures.¹⁸⁰ The provision also overcomes the second problem by clarifying the priorities between fixture security and real estate interests without otherwise disturbing the substantive law that applies to such fixtures. A fixture financier will prevail over a real estate interest (whether or not a real estate notification has been filed) so long as the tenant-debtor has in law a right of removal against that real estate party. As was shown earlier, the courts have been very generous to tenants.¹⁸¹ The continuation of the secured party's priority "for a reasonable time" after the debtor's right of removal terminates can be justified on the grounds that the fixture lender needs some time to learn of the termination of the debtor's right of removal and to initiate proceedings to enforce the security interest.

VI. GOODS AFFIXED BY CONTRACTORS

A. *The Problem: Lack of Protection for a Landowner Against a Contractor under Section 36*

The second major situation in which goods are affixed to land by someone who does not own the real estate concerns goods affixed by contractors. In a typical situation, a builder and a landowner enter into a contract in which the owner agrees to pay a fixed price for the construction. The total price usually includes not only the cost of the labour and equipment, but also all the materials that are to become part of the completed structure. The contractor may, however, purchase some of the materials subject to a security interest in favour of the supplier. In such a case, what protection do landowners who have paid contractors in expectation of receiving unencumbered property have? Moreover, are

¹⁷⁹ 1972 Code, *supra*, note 14, § 9-313(5)(b).

¹⁸⁰ While the section's principal application will probably be in dealing with tenants' fixtures, it can also be used by a licensee or an owner of an easement who have affixed goods to the land: *ibid.* at 114.

¹⁸¹ See text accompanying notes 172 & 173, *supra*. See generally Niles, *supra*, note 39 at 570-74; Oosterhoff & Rayner, *supra*, note 23 at 1047-54.

landowners in any better position if, under the contract, they make their payments to the contractor after the goods have been installed and without knowledge of the outstanding security interests in those fixtures?

Of course, the landowner can bring an action against the contractor who has acquired the fixtures subject to a security interest for breaching the contract. This, however, is usually of small comfort to the landowner because by then the contractor is in default with the supplier and is probably on the verge of bankruptcy.¹⁸² Moreover, the contract is not enforceable against third parties such as the supplier or conditional seller.

A literal reading of section 36 suggests that the *PPSA* does not afford the landowner any protection. In those instances when the landowner has paid the contractor before the encumbered goods are affixed to the land, section 36(1) gives priority to the fixture supplier. Even when the landowner waits until after the goods are installed before paying the contractor (and payment is made without knowledge of the encumbrance), the landowner can only succeed if the exceptions in section 36(3) apply. Unfortunately, unless a court is bold enough to "jump the hurdle,"¹⁸³ it is unlikely to regard the landowner as a subsequent purchaser for value of an interest in the realty (section 36(3)(a)) or a creditor with a prior encumbrance of record on the realty (section 36(3)(c)). Yet, unlike most real estate parties who claim an interest in the fixtures only because they have an interest in the real property, the landowner in the contractor example claims an interest in the fixtures themselves or *qua* buyer under a contract with the builder. Thus, the equities in this particular case are even more in favour of the landowner than they are in the case of a construction mortgagee, and the latter is provided some protection under the *PPSA*. In fact, the supplier's interest has been referred to as being "the worst kind of secret lien."¹⁸⁴ Therefore, some form of protection should be provided to the landowner. It is surprising that the *Act* fails

¹⁸² See, e.g., *Manning* (C.A.), *supra*, note 8 at 69; *Camco Inc. v. Frances Olson Realty (1979) Ltd* (1986), 6 P.P.S.A.C. 167 at 172 (Sask. C.A.) [hereinafter *Camco Inc.*].

¹⁸³ Gilmore, *supra*, note 11 at 834. Professor Gilmore suggests that under these very peculiar circumstances, a "creditor" as referred to in s. 36(3)(c) should be construed to include an 'owner'. In other words, he continues, "the case of an owner, which is evidently on all fours with that of the mortgagee, [should] be treated as a *casus omissus*, so that the rule protecting advances under prior mortgages may be applied by analogy." See also Gordon, *supra*, note 12 at 669-70, who argues that this case should be treated as *casus omissus*. However, he believes that it should be determined by non-*Code* law and not by s. 36(3)(c).

¹⁸⁴ Gordon, *supra*, note 12 at 669.

to deal explicitly with this situation because the *Conditional Sales Act* did appear to address this problem.¹⁸⁵

B. *Availability of Protection for the Landowner Under Other Provisions of the PPSA*

Commentators, horrified by the anticipated result of the fixture section in respect of goods affixed by contractors, have suggested several arguments that a sympathetic court might accept to allow a landowner to prevail over a supplier's security interest. First, the landowner can argue that the goods affixed to the realty are not fixtures but building materials. Accordingly, the *PPSA* does not apply and the secured party may not remove the goods unless the landowner consents or unless some other statute, such as the *Construction Lien Act*,¹⁸⁶ permits such action.¹⁸⁷ However, as explained above,¹⁸⁸ if the courts interpret the section as contemplated by the drafters, the term 'building materials' will be construed much more narrowly than has been done in the past.

If the court holds that the collateral is a fixture then the landowner can argue that by virtue of section 27(1) the supplier or fixture financier has a security interest not in the goods sold but in the proceeds. Like the inventory financing arrangement to which section 27 is most applicable, an examination of the entire supplier-contractor arrangement shows that the parties' intention is that the contractor is to dispose of the goods to the landowner; that is, "the secured party [the supplier] *expressly or impliedly* authorized such dealing" between the debtor (the contractor) and the buyer (the landowner).¹⁸⁹ It follows then that the secured party has lost the security interest in the goods, giving priority

¹⁸⁵ Section 14(3) of the *Conditional Sales Act*, *supra*, note 4, provided that "[t]he registration of a contract [presumably meaning that a notice of the contract was to be registered] under this section shall be deemed to be actual notice to the owner of the land or an interest therein or to a subsequent purchaser, mortgagee or other encumbrancer of the land or an interest therein." [Emphasis added.] Since s. 10 is subject to s. 14, a court could hold that the landowner has a right to retain the fixture without paying the balance (as is required under s. 10) unless the supplier has registered the contract. See *Murphy Wall Bed Co.*, *supra*, note 52 at 108, where Mr. Justice Ferguson for the Ontario Court of Appeal said in *obiter* that if the contract is not filed then the vendor has no right to remove the goods affixed to the realty. See also *Campbell*, *supra*, note 23 at 59, 61.

¹⁸⁶ *Supra*, note 27.

¹⁸⁷ See, e.g., *Manning* (C.A.), *supra*, note 8 at 73-74, where Monnin C.J.M. said, as *obiter*, that with the exception of the gas furnace and water heater most of the items that the contractor intended to remove were "building materials," and thus they were not subject to removal as fixtures. In a separate and concurring judgment, O'Sullivan J.A. said (at 78), as *obiter*, that he had no doubt that in this country a furnace and water heater were regarded as part of a house (*i.e.*, building materials) and not as fixtures.

¹⁸⁸ See notes 37 and 38, *supra* and accompanying text.

¹⁸⁹ *PPSA*, s. 27(1)(a).

to the holder of the real estate interest.¹⁹⁰ Section 27(1), however, gives the supplier a security interest in the proceeds, which can be perfected under section 27(2).¹⁹¹

A third line of defence advocated by a number of commentators¹⁹² would claim that the owner's position is analogous to that of a buyer in the ordinary course of business who, under section 30(1) of the *PPSA*, takes free of security interests created by the seller. The section, however, is poorly drafted and leaves a great many questions unanswered. The question that is most relevant to the current discussion is whether the disposition of goods in the ordinary course of business must be a "sale" as defined by the *Sale of Goods Act*.¹⁹³

A contract for the sale of goods, in Anglo-Canadian law, "is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price."¹⁹⁴ One of the four features that courts use to differentiate a "sale" from other types

¹⁹⁰ See, e.g., *Manning (Q.B.)*, *supra*, note 8 at 249-51; *Delton Cabinet v. Yorkville Homes Ltd* (1985), 65 A.R. 384 (Alta. Q.B.), where a sub-contractor had installed kitchen cabinets into a house being constructed by a builder. The builder sold the lot and the house to a buyer. The Court refused the sub-contractor's application to remove the cabinets because, *inter alia*, the builder was a mercantile agent of the kind contemplated by s. 2(1) of the *Factors Act*, R.S.A. 1980, c. F-1. It therefore follows from the authorities, the court said (at 386), that the sub-contractor has "clothed . . . [the builder] with implied authority to sell the cabinets and to transfer a good title free from the encumbrance to a bona fide purchaser who has no knowledge of the existence of the encumbrance."

¹⁹¹ For a discussion of many of the problems inherent in this section, see J. Alpert, "Perfection and Tracing of Proceeds Under the Personal Property Security Act" (1984) 9 Can. Bus. L.J. 467 and J.S. Ziegel, "The Quickening Pace of Jurisprudence Under the Ontario Personal Property Act" (1980) 4 Can. Bus. L.J. 54 at 78-81. Many of these problems will, however, be eliminated by changes recommended by the Advisory Committee: *1985 Draft Act*, *supra*, note 15 at 35-37.

¹⁹² Leary & Rucci, *supra*, note 97 at 394; Kripke, *supra*, note 11 at 69-70. See also McLaren II, *supra*, note 8 at 254 n.76.

¹⁹³ *Supra*, note 89, s. 2(1).

Other serious ambiguities in this section include: (1) the meaning of "ordinary course of business" (see B. Clark, *The Law of Secured Transactions Under the Uniform Commercial Code* (Boston: Warren, Gorham & Lamont, 1980); *1985 Cumulative Supplement No. 3* at § 3.41[1]; McLaren I, *supra*, note 8 at § 12.05[2][a]; but cf. *Camco Inc.*, *supra*, note 182 at 186-87); (2) whether the buyer must be a purchaser "in good faith" and "without notice" of the outstanding security interest (see, e.g., *Fairline Boats Ltd v. Leger* (1980), 1 P.P.S.A.C. 218 at 227-28 (Ont. H.C.) (by implication)); (3) whether the buyer's consideration must be executed before the buyer receives notice of the seller's defective title (cf. the definition of "value" in s. 1(z) of the *PPSA* and the expanded meaning in s. 1(1) of the *1985 Draft Act*, *supra*, note 15; see also J.S. Ziegel, "The Legal Problems of Wholesale Financing of Durable Goods in Canada" (1963) 41 Can. B. Rev. 54 at 95, where he discusses this problem with respect to the old "trader's" section in the conditional sales legislation); and (4) whether the security interest must be created by the seller (see Clark, *ibid.*, at § 3.4[3] and the cases cited therein, which applied the rule that buyers in the ordinary course of business are not protected against a security interest created by a former owner who is not their seller and the few cases in which the buyer was able to prevail by arguing a different theory (e.g., acquiescence on the part of the bank; agency relationship between the two dealers so that the first dealer was in reality the 'seller'; and an entrustment theory based on ss. 2-403(2) & (3) which provides that a person who "entrusts" the possession of goods to a dealer loses title to a buyer in the ordinary course from the dealer)).

¹⁹⁴ *SGA*, *ibid.*, s. 2(1).

four features that courts use to differentiate a "sale" from other types of contracts is that the subject matter of the contract must be goods.¹⁹⁵ Contracts between a contractor and a landowner, however, have generally been held by the courts to be contracts for work and labour or for the provision of services as opposed to contracts of sale of goods.¹⁹⁶ Therefore, if section 30(1) only protects a buyer whose transaction is a sale as defined by the *Sale of Goods Act*, then the protection afforded by section 30(1) will not apply to a contract between the contractor and the landowner.

A technical sale should not be a prerequisite for a buyer to be afforded protection by section 30(1) of the *PPSA*. A sale is really a species of contract law. Although many of the rules of contract apply generally to all sales, some rules have been statutorily enacted or judicially developed and now only apply to sales of particular types of property. As a result, different principles of law exist depending upon the type of property involved (goods, land, services, leasehold interests, choses in action, negotiable instruments, and so on). The language and judicial interpretation of the *Sale of Goods Act* clearly show that the hallmark and primary purpose of a contract of sale of goods is the transfer of property in the goods from one person to another.¹⁹⁷ The passing of property in

¹⁹⁵ The other three essential features of a sale of goods are a purchase, the passing of property, and the payment of money for such goods. See generally G.H.L. Fridman, *Sale of Goods in Canada*, 3d ed. (Toronto: Carswell, 1986) at 11-23. "Goods" are defined in s. 1(1)(g) of the *SGA* to include "all chattels personal, other than things in action and money and includes emblements, industrial growing crops, and things attached to or forming part of the land that are agreed to be severed before sale or under the contract of sale."

¹⁹⁶ See, e.g., *Allis-Chalmers-Bullock Co. v. Walker* (1910), 15 W.L.R. 357 (C.A.) (contract for supply and installation of machinery for operating lighting and ventilating plant; held not a sale but a contract for work and materials); *Lundrigan's Ltd v. Newfoundland* (1975), 15 Nfld. & P.E.I.R. 467 at 483-85 (Nfld. T.D.) (contract to manufacture and install concrete panels; held *SGA* is not generally applicable to construction contracts); *Scott Maritimes Pulp Co. v. B.F. Goodrich Canada Ltd* (1977), 19 N.S.R. (2d) 181 at 196-97 (C.A.) (installation of rubber cover on a press roll; held not a sale); *R.E. Nowell Fisheries Ltd v. Gow* (1983), 22 B.L.R. 179 (N.S.T.D.) (contract for supply and installation of freezer system not constituting a contract for sale of goods). Cf. *Unident Ltd v. DeLong, Joyce and Ash Temple Ltd* (1981), 50 N.S.R. (2d) 1 at 4 (N.S.S.C.) (supply and installation of dental office equipment constituting a contract for the sale of the goods, the installation work being only incidental to the purchase). See also A.G. Guest, ed., *Benjamin's Sale of Goods*, 2d ed. (London: Sweet & Maxwell, 1981) at § 42 and cases cited therein. And see Leary & Rucci, *supra*, note 97 at 394, where they argue that even if the contract is not strictly a sale of goods, the policy behind § 9-307(1), comparable to s. 30(1) of the *PPSA*, "cries out for the application of the rule of the subsection by analogy, or by ruling that for section [30(1)] purposes a construction contract 'includes' a contract of sale." In support of the latter proposition, the authors (at 394 n. 87a) cite *Vonins Inc. v. Raff* (1968), 101 N.J. Super. 172, which held that a plumbing installation contract includes a sale of fixtures for the purpose of § 2-326.

In distinguishing between a contract of sale of goods and one for work and materials, Canadian courts consider whether the primary objective of the contract is the transfer of title in something that was not originally the property of the buyer. If so, the contract will be one of a sale of goods. Alternatively, if the primary purpose of the contract is the performance of certain work or services and the fact that title has passed is only incidental, then the contract will not be one of a sale of goods: Fridman, *ibid.* at 25.

¹⁹⁷ Fridman, *ibid.* at 12, 15, 31-32, 101-104.

the goods is important because this step gives rise to the proprietary and contractual rights and duties that are contained in the *Sale of Goods Act*.¹⁹⁸

The underlying policy of section 30(1) of the *PPSA* is, however, very different from that found in the *Sale of Goods Act*. Section 30(1) encourages the marketability of goods and protects the reliance interests of buyers who assume that sellers will use the proceeds of the sales to repay any liens on the property sold.¹⁹⁹ The provision should, therefore, be interpreted liberally in their favour. In fact, the Ontario Court of Appeal in *International Business Machines Co. v. Guelph Board of Education*²⁰⁰ and in *Dominion Lock Joint Pipe Co. v. York*²⁰¹ broadly interpreted a comparable section in the former *Conditional Sales Act*.²⁰²

In the *York* case, a contractor purchased some sewer pipes from the plaintiff on a conditional sales agreement. These pipes were then installed by the contractor in the defendant's sewage system. When the contractor failed to pay the amount owing on the pipes, the plaintiff sought to recover its goods from the defendant. The defendant argued, *inter alia*, that it was protected by the trader's provisions of the *Conditional Sales Act*.²⁰³ The plaintiff denied that the defendant could be protected by this section on the ground that there was no technical sale between the contractor and the defendant. In rejecting the plaintiff's argument, Mr. Justice Middleton, speaking for the Court, first explained that the section was introduced to protect innocent buyers and therefore should be interpreted broadly in their favour.²⁰⁴ He then responded to the plaintiff's

¹⁹⁸ *Ibid.* at 31-32.

¹⁹⁹ See, e.g., *Fairline Boats Ltd v. Leger*, *supra*, note 193 at 220-21, where Mr. Justice Linden stated that

[t]he objective of this section, as I understand it, is to permit commerce to proceed expeditiously without the need for purchasers of goods to check into the titles of sellers in the ordinary course of their business. Purchasers are allowed by our law to rely on sellers using the proceeds of sales to repay any liens on the property sold. In these days inventory is almost invariably financed, and as a result is almost invariably subject to liens of one kind or another. To require searches and other measures to protect lenders in every transaction would stultify commercial dealings, and so the Legislature exempts buyers in the ordinary course of business from these onerous provisions, even where they know that a lien is in existence. The risk is placed on lenders of an occasional dishonest dealer who may sell some of his goods in the ordinary course of business and then fail to repay the debt because "he is in a much better position than the buyer to weigh the risk."

See also *Camco*, *supra*, note 182 at 181, 186; *Ziegel*, *supra*, note 193 at 85-86.

²⁰⁰ (1927), [1927] 4 D.L.R. 632, *aff'd* (1928), [1928] S.C.R. 200.

²⁰¹ *Supra*, note 115.

²⁰² Section 3(4) of the *Conditional Sales Act*, R.S.O. 1914, c. 136 provided that: "where such trader or other person resells the goods in the ordinary course of his business, the property in and ownership of such goods shall pass to the purchaser notwithstanding that the provisions of this Act have been complied with."

²⁰³ *Ibid.*

²⁰⁴ *Supra*, note 115 at 808.

argument that the contract was not a sale as defined by the *Sale of Goods Act* but a contract for the construction of the sewer by stating:

[w]hile this is in one sense so, it was unquestionably part of the contract that the title to the goods should pass to the [defendant], and this amounts to a resale within the meaning of the . . . [Conditional Sales Act]. This view is, I think, in accordance with that entertained by this court in *International Business Machines v. Guelph Board of Education*.²⁰⁵

In the *Guelph* case,²⁰⁶ Mr. Justice Ferguson for the Ontario Court of Appeal said that the court should give the words of the statute "their grammatical and natural meaning and effect," given that section 3(4) of the *Conditional Sales Act* was "designed and intended to protect purchasers rather than vendors."²⁰⁷

As the two cases clearly illustrate, goods are frequently distributed in ordinary business transactions that do not conform to a technical sale of goods. No purpose can be advanced to explain why only "buyers" as defined by the *Sale of Goods Act* should be protected, instead of all buyers. The opportunities for deception appear to be the same in both instances.²⁰⁸ A construction contract between a contractor and a landowner should be viewed as a sale within the meaning contemplated by section 30(1) of the *PPSA*.²⁰⁹

A fourth argument will also be possible once the *1985 Draft Act* is passed. In the *1985 Draft Act*, the term "debtor" means not only "a person who owes payment or other performance of the obligation secured"²¹⁰ but also the owner of the collateral when the debtor does

²⁰⁵ *Dominion Lock Joint Pipe Co. v. York, ibid.*

²⁰⁶ *Supra*, note 200. In that case, the plaintiff conditionally sold some clocks to a dealer of electrical supplies who was to install them in the defendant's building.

²⁰⁷ *Ibid.* at 634 (Ont. C.A.).

²⁰⁸ Ziegel, *supra*, note 193 at 88-89.

²⁰⁹ See, e.g., *O'Dell v. Kunkel's Inc.* (1978), 24 U.C.C. Rep. 227 at 231 (Okla. S.C.), where the security interest of a contractor who installed the plumbing, central heating, and air conditioning into a residence was discharged by virtue of § 9-307 of the *1962 Code* (the equivalent of s. 30(1) of the *PPSA*) when the builder sold the house.

In *Manning* (Q.B.), *supra*, note 8 at 251, Mr. Justice Scollin did not consider whether s. 30(1) was limited to sales as defined by the *SGA*. He said that s. 30(1) of the Manitoba *PPSA* was not applicable because the sale of heating equipment by a home builder was not in the ordinary course of business. This cannot be correct since an agreement with a builder includes not only the construction of the shell of the house but also the furnishing of heating equipment and other articles which are all necessary to make a house a home. See, for example, *Delton Cabinet Manufacturing Ltd v. Yorkville Homes Ltd*, *supra*, note 190 at 386, where the encumbrance of a sub-contractor who installed kitchen cabinets into a new house was discharged by virtue of s. 2(1) of the *Factors Act* when the house was sold. This was so because, *inter alia*, the builder "was in possession of the cabinets in its capacity as a mercantile agent and sold these cabinets as part of the home to [the buyer of the house] in the ordinary course of its business." [Emphasis added.]

²¹⁰ The same wording for this portion of the definition is presently found in s. 1(g) of the current *Act*. See *PPSA*, s. 1(g).

not own the collateral.²¹¹ A serious question then arises as to whether the financing statement and the real estate notification, which refer only to the contractor, and the security agreement, which is signed only by the contractor, would be effective under the *1985 Draft Act* because they do not involve all of the "debtors". Right from the start a manifest intention that the landowner is to have ownership rights in the collateral is clear. In fact, once the goods are affixed and payment has been made by the landowner, the latter will have exclusive rights in the collateral as against the contractor. Therefore, when ownership is divided or when only one part owner owes the money, both should be considered debtors for the purposes of the *1985 Draft Act*. Subsequently, both would have to be referred to in the financing statement and in the real estate notification and, more importantly, both would have to sign the security agreement.²¹²

Was such an interpretation contemplated by the drafters? Arguably, "debtor" does not mean the same thing in all contexts. One could say that the expanded definition of "debtor" is applicable only in Part V of the *1985 Draft Act* (dealing with the rights and duties of the secured party and the debtor on default). In other cases, such as the registration requirements and the formal requisites for security agreements, the customary meaning of the term "debtor" is more appropriate. The commentary of the drafters of the *1985 Draft Act* seems to indicate that they did not contemplate that all of the parties set out in the definition of "debtor" should qualify as debtors under all of the applicable provisions; only under those sections found in Part V of the *1985 Draft Act* was the expanded definition for "debtor" to apply.²¹³

Nevertheless, acceptance of the broader construction becomes more likely in light of the situation facing the court: the suppliers know that the goods are to be installed on the land; the landowners have no way of ensuring that the goods are free of a security interest because the suppliers have not used the means available to them to give the owner at least constructive notice of the security interest.²¹⁴ By expanding the

²¹¹ *1985 Draft Act*, *supra*, note 15, s. 1(1) at 2-3. The exact wording of this last portion of the definition is as follows: "where the person who owes payment or other performance of the obligation secured is not the owner of the collateral, 'debtor' includes . . . an owner of the collateral in any provision of this Act dealing with [the] collateral. . . ." [Emphasis added.]

²¹² A similar argument has been made with respect to the *1962 Code*. See Leary & Rucci, *supra*, note 97 at 394-95. See, e.g., *K.N.C. Wholesale, Inc. v. AWMCO, Inc.* (1976), 18 U.C.C. Rep. 1303 at 1306-7 (Cal. C.A.) and *White Star Distributors, Inc. v. Kennedy* (1978), 25 U.C.C. Rep. 1446 at 1448 (N.Y.S.C. App. Div.) where both courts held that where the debtor and the owner of the collateral are not the same person, both names must appear on the financing statement in order to perfect the security interest. See also R.A. Anderson, *Anderson on the Uniform Commercial Code*, vol. 4, 2d ed. (Rochester: Lawyers Co-operative, 1971) at § 9-402:20 and cases cited therein.

²¹³ *Supra*, note 15 at 7. Cf. McLaren I, *supra*, note 8 at § 1.09[8], and see also the cases cited in note 212.

²¹⁴ See text accompanying note 184, *supra*.

definition of "debtor," the 1985 *Draft Act* would force the supplier to notify the landowner and, in effect, to obtain the owner's prior consent before affixing the goods to the owner's property. To require the supplier to do this seems reasonable in the circumstances.

A fifth argument was considered and accepted by Mr. Justice Scollin of the Manitoba Queen's Bench in *Manning v. Furnasman Heating Ltd.*²¹⁵ The conditional sales agreement in *Manning* involved the future sale and installation of the fixtures, and the judge concluded that the builder could not have acquired any rights in the specific heating equipment until the goods had been installed. He reasoned that because a security interest did not attach *before* the goods became fixtures, it must have attached *after* they became fixtures.²¹⁶ Since this was a post-affixation security interest, he concluded that section 36(3) of the *Manitoba Act* applied²¹⁷ and not section 36(2)²¹⁸ as the contractor had argued. Under section 36(3) a secured party with a post-affixation security in fixtures could only prevail over a person with a pre-existing registered interest in the real estate if the secured party had entered into a priority agreement with the real estate party. Having failed to conclude such an agreement, the contractor was not entitled to priority.

Although Scollin J.'s argument is initially attractive, it must ultimately be rejected because his argument incorrectly applies the third element for attachment ("the debtor has rights in the collateral").²¹⁹ In all fairness to the trial judge, determining when a debtor has acquired rights in the collateral is not always an easy matter. However, the cases clearly indicate that something less than legal title is necessary to satisfy section 12(1)(c).²²⁰ Scollin J. was correct in holding that the builder did not have enough rights for attachment when the contract was first made because the

²¹⁵ *Supra*, note 8. The case was subsequently affirmed on other grounds by a majority of the Court of Appeal. Cf. O'Sullivan J.'s minority judgment where he said (at 78), *inter alia*, that he adopts the reasons of the majority and of the trial judge.

²¹⁶ Scollin J. said (*ibid.* at 252) that although "[a] purist might suggest that the security interest attached contemporaneously with the goods becoming fixtures . . . the scheme of the [Manitoba PPSA] does not recognize this nicety."

²¹⁷ Section 36(3) of the *Manitoba PPSA* corresponds to s. 36(2) of the *Ontario PPSA*. Section 36(2) reads as follows:

Subject to subsection (3), a security interest that attached to goods after they became fixtures has priority over the claim of any person who subsequently acquired an interest in the real property, but not over any person who had a registered interest in the real property at the time the security interest attached to the goods and who has not consented in writing to the security interest or disclaimed an interest in the goods as fixtures.

²¹⁸ Section 36(2) of the *Manitoba Act* is equivalent to s. 36(1) of the *Ontario PPSA*. Both sections only apply to pre-affixation security interests in fixtures.

²¹⁹ Section 12(1)(c). The other two elements are an intention to attach (s. 12(1)(a)) and the giving of value (s. 12(1)(b)).

²²⁰ McLaren I, *supra*, note 8 at § 2.01[2] n.5.1 and cases cited therein.

builder's equipment had not yet been identified or selected. However, once the equipment was identified, selected, and delivered to the builder, the builder had rights to the equipment even though it had not yet been installed by the contractor.²²¹ Even if Scollin J. was correct that the delivery of the equipment did not give the builder sufficient rights in the collateral for attachment, at some point as the equipment was being installed, but *before* the equipment was transformed into a fixture, the builder must have acquired the necessary rights to the equipment. In other words, the security interest in the equipment attached at least a split second before the equipment changed into a fixture. It follows, therefore, that the priority rule in section 36(2) of the Manitoba *PPSA* for pre-affixation security interests was the more appropriate section in this type of case. Accordingly, the contractor would be given an automatic priority over the pre-existing real estate interest unless one of the other four arguments outlined above applied to subordinate the contractor's security interest in the fixtures.

In summary, the failure of the *Act* to expressly protect the landowner can be overcome by judicial construction. There are four possible arguments that a court sympathetic to the landowner's position might accept.²²² If the courts take a contrary position, then clarifying amendments should be enacted. One possible solution would be to require the supplier to obtain the prior consent of the landowner before a fixture financier would be allowed to remove the goods affixed to the owner's real estate.²²³

VII. SUMMARY AND CONCLUSION

The fixture section attempts to balance the reliance interests of both the real estate and fixture parties. The section thus stimulates further

²²¹ See, e.g., *In re County Green Limited Partnership* (1977), 23 U.C.C. Rep. 168 at 172 (U.S.D.C., Va.), where at the very latest the debtor had acquired rights in the appliances when they were delivered to the construction site; *Galleon Industries, Inc. v. Lewyn Machinery Co., Inc.* (1973), 12 U.C.C. Rep. 1224 (Ala. App.).

²²² See, e.g., *Manning* (Q.B.), *supra*, note 8 (supplier's security interest in the goods is discharged, but continues in the proceeds); *O'Dell v. Kunkel's Inc.*, *supra*, note 209 (landowner is a buyer in the ordinary course of business); *Manning* (C.A.), *supra*, note 8 (Monnin C.J.M. holding, for the majority, that most of the items installed by contractor had become building materials and O'Sullivan J.A., in a separate and concurring judgment, including in that list the furnace and water heater); and the cases cited in note 212, *supra* (financing statement must name both the owner of the collateral and the obligor on the debt as the "debtor" in order to perfect the security interest). As stated above, this last argument can only be used once the 1985 *Draft Act* becomes law.

²²³ A similar result is now required in the United States. The 1972 *Code's* revision of the priority rules, assuming that none of the exceptions in §§ 9-313(4)(c)(d) & (5) apply, forces the supplier to obtain a prior written consent from the owner to prevail over the land interest. Such a result is achieved because the general priority rule of the fixture section (§ 9-313(7)) subordinates the fixture financier's interest to that of the real estate interest.

investment throughout the economy by encouraging the commitment of new capital to the improvement of real estate and the modernization and expansion of industry while at the same time protecting the capital that has already been invested. The *Act* achieves this by ushering in some important substantive changes with respect to fixture law in Ontario. Perhaps the most dramatic of these is that *all* fixture secured parties may on the debtor's default remove the collateral from the real estate irrespective of the economic loss to the realty.²²⁴ The secured party, however, must reimburse the owner or encumbrancer of the real property for the cost of repairing any physical injury to the realty caused by the removal.²²⁵ In addition, the priority rules of the section primarily recognize reliance interests and show an obvious preference for the purchase money security interest. On the whole, the policy behind these rules is a sound one.

Unfortunately, the section is not a panacea for the problems that lurk in this complicated area of law. A number of these problems have been identified and examined. Many of these problems can be resolved by judicial construction. For others, however, legislative amendments or precautionary measures by the fixture financier are necessary to make the section more workable and trouble-free.

The Advisory Committee's recommendations contained in the *1985 Draft Act* do not correct many of the inherent weaknesses in the section. While the *1972 Code* can be used to show how some of these problems can be eliminated, it is also flawed by ambiguities and omissions. More importantly, its general policy shift in favour of the real estate financing community, necessary to meet that Bar's objections to the substance of the previous *Code*, is contrary to the long-standing position in Ontario. Thus, further analysis and discussion by the drafters and other interested parties are required so that fixture financing in Ontario can be concluded with "reasonable simplicity and certainty."²²⁶ The need for clarity and certainty in the *PPSA* is undoubtedly difficult to achieve but nonetheless should be attempted. The need becomes particularly acute when one is reminded that the *Act's* provisions will only be tested when the normal

²²⁴ Prior to the *PPSA*, only a conditional seller had a right of removal by virtue of s. 10(1) of the *Conditional Sales Act*, *supra*, note 4. Other creditors, such as a chattel mortgagee, were not given a similar right of removal either under the common law or under the *Bills of Sale and Chattel Mortgages Act*, *supra*, note 4.

²²⁵ Under the common law, there does not appear to exist an express duty of reimbursement: McLaren II, *supra*, note 8 at 261 n. 85. Cf. *Markle v. Houck and Winkler* (1860), 19 U.C.Q.B. 164 at 168, where the defendant was entitled to remove articles affixed to the realty but was liable in damages for disturbing the freehold. Damages were also possible for breach of covenants to repair, leave in repair, or yield up in repair. With respect to this latter type of covenant, see generally Oosterhoff & Rayner, *supra*, note 23 at 1059-61; Rhodes, *supra*, note 23 at § 13:3:12.

²²⁶ Catzman *et al.*, *supra*, note 1 at 3.

business relationship has collapsed and the rights of other parties have become involved.